99TH CONGRESS *2d Session*	HOUSE OF REPRESENTATIVES	REPORT 99-624

FUTURES TRADING ACT OF 1986

JUNE 6, 1986.—Committed to the Committee of the Whole House on the State of the Union and ordered to be printed

Mr. DE LA GARZA, from the Committee on Agriculture, submitted the following

REPORT

together with

ADDITIONAL AND DISSENTING VIEWS

[To accompany H.R. 4613]

[Including Congressional Budget Office cost estimate]

The Committee on Agriculture, to whom was referred the bill (H.R. 4613) to reauthorize appropriations to carry out the Commodity Exchange Act, and to make technical improvements to that Act, having considered the same, report favorably thereon with an amendment and recommend that the bill as amended do pass.

The amendment is as follows:

Strike out all after the enacting clause and insert in lieu thereof the following:

SHORT TITLE

SECTION 1. This Act may be cited as the "Futures Trading Act of 1986".

FRAUDULENT PRACTICES

SEC. 2. Section 4b of the Commodity Exchange Act (7 U.S.C. 6b) is amended by—

(1) striking out "on or subject to the rules of any contract market," the second place it appears in the first sentence; and

(2) adding, at the end thereof, the following:

"Nothing in this section shall apply to any activity that occurs on a board of trade, exchange, market, or clearinghouse for such board of trade, exchange, or market, located outside the United States, its territories, or its possessions involving any contract of sale of a commodity for future delivery that is made, or to be made, on or subject to the rules of such board of trade, exchange, or market.".

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OPTIONS TRANSACTIONS

SEC. 3. Section 4c(c) of the Commodity Exchange Act (7 U.S.C. 6c(c)) is amended to read as follows:

"(c) Not later than 90 days after the date of the enactment of the Futures Trading Act of 1986, the Commission shall issue regulations—

"(1) to eliminate the pilot status of its program for the trading of commodity options on contract markets, including any numerical restrictions on the number of commodities or option contracts for which a contract market may be designated; and

"(2) otherwise to continue to permit the trading of such commodity options under such terms and conditions that the Commission from time to time may prescribe.".

EXTRATERRITORIAL SERVICE OF SUBPENAS

SEC. 4. Section 6(b) of the Commodity Exchange Act (7 U.S.C. 15) is amended by—

(1) inserting "(except as provided in the proviso to the following sentence)" immediately before "may administer oaths and affirmations, subpena witnesses" in the third sentence;

(2) striking out "or any State" in the fourth sentence and inserting in lieu thereof ", any State, or any foreign country or jurisdiction"; and

(3) inserting, immediately before the period at the end of the fourth sentence, a semicolon and "and a subpena issued under this subsection may be served on any person who is not to be found within the territorial jurisdiction of any court of the United States in such manner as the Federal Rules of Civil Procedure prescribe for service of process in a foreign country: *Provided,* That a subpena to be served on a person who is not to be found within the territorial jurisdiction of any court of the United States may be issued only on the prior approval of the Commission".

EX PARTE APPOINTMENTS OF TEMPORARY RECEIVERS

SEC. 5. The proviso to the first sentence of section 6c of the Commodity Exchange Act (7 U.S.C. 13a-1) is amended by inserting in the parenthetical phrase immediately before the close parenthesis ", and other than an order appointing a temporary receiver to administer any books, records, documents, funds, assets, or other property that is subject to such restraining order and to perform such other duties as the court may consider appropriate".

CERTAIN PROHIBITED TRANSACTIONS

SEC. 6. Section 9(d) of the Commodity Exchange Act (7 U.S.C. 13(d)) is amended by—

(1) inserting immediately before the period at the end of the first sentence the following: "if nonpublic information is used in the investment transaction, if the investment transaction is prohibited by rule or regulation of the Commission, or if the investment transaction is effected by means of any instrument regulated by the Commission"; and

(2) striking out the second and third sentences and inserting in lieu thereof the following: "The foregoing prohibitions shall not apply to any transaction or class of transactions that the Commission, by rule or regulation, has determined would not be contrary to the public interest or otherwise inconsistent with the purposes of this section.".

REAUTHORIZATION

SEC. 7. Effective October 1, 1986, section 12(d) of the Commodity Exchange Act (7 U.S.C. 16(d)) is amended to read as follows:

"(d) There are authorized to be appropriated to carry out this Act such sums as may be necessary for each of the fiscal years during the period beginning October 1, 1986, and ending September 30, 1989.".

REGISTERED FUTURES ASSOCIATION DISCIPLINARY ACTIONS AND MEMBERSHIP RESTRICTIONS

SEC. 8. Subsections (h) and (i) of section 17 of the Commodity Exchange Act (7 U.S.C. 21 (h), (i)) are amended to read as follows:

"(h)(1) If any registered futures association takes any final disciplinary action against a member thereof or a person associated with a member, or denies admission to any person seeking membership therein or bars any person from being associated with a member, the association promptly shall give notice thereof to such member or person and file notice thereof with the Commission. The notice shall be in such form and contain such information as the Commission, by rule or regulation, may prescribe as necessary or appropriate in furtherance of the purpose of this Act.

"(2) Any action with respect to which a registered futures association is required by paragraph (1) of this subsection to file notice shall be subject to review by the Commission on its motion, or an application by any person aggrieved thereby. Such application shall be filed within thirty days after the date such notice is filed with the Commission and received by the aggrieved person, or within such longer period as the Commission may determine.

"(3) Application to the Commission for review, or the institution of review by the Commission on its own motion, shall not operate as a stay of such action unless the Commission othewise orders, summarily or after notice and opportunity for hearing on the question of a stay (which hearing may consist solely of the submission of affidavits or presentation of oral arguments). The Commission shall establish procedures for expedited consideration and determination of the question of a stay.

"(i)(1) In a proceeding to review a final disciplinary action taken by a registered futures association against a member thereof or a person associated with a member, after appropriate notice and opportunity for a hearing (which hearing may consist solely of consideration of the record before the association and opportunity for the presentation of supporting reasons to affirm, modify, or set aside the sanction imposed by the association)—

"(A) if the Commission finds that—

"(i) the member or person associated with a member has engaged in the acts or practices, or has omitted the acts, that the association has found the member or person to have engaged in or omitted;

"(ii) the acts or practices, or omissions to act, are in violation of the rules of the association specified in the determination of the association; and

"(iii) such rules are, and were applied in a manner, consistent with the purposes of this Act;

the Commission, by order, shall so declare and, as appropriate, affirm the sanction imposed by the association, modify the sanction in accordance with paragraph (2) of this subsection, or remand the case to the association for further proceedings; or

"(B) if the Commission does not make any such finding, the Commission, by order, shall set aside the sanction imposed by the association and, if appropriate, remand the case to the association for further proceedings.

"(2) If after a proceeding in accordance with paragraph (1) of this subsection, the Commission finds that any penalty imposed on a member or person associated with a member is excessive or oppressive, having due regard for the public interest, the Commission, by order, shall cancel, reduce, or require the remission of the penalty.

"(3) In a proceeding to review the denial of membership in a registered futures association or the barring of any person from being associated with a member, after appropriate notice and opportunity for a hearing (which hearing may consist solely of consideration of the record before the association and opportunity for the presentation of supporting reasons to affirm, modify, or set aside the action of the association—

"(A) if the Commission finds that—

"(i) the specific grounds on which the denial or bar is based exist in fact;

"(ii) the denial or bar is in accordance with the rules of the association; and

"(iii) such rules are, and were applied in a manner, consistent with the purposes of this Act;

The Commission, by order, shall so declare and, as appropriate, affirm or modify the action of the association, or remand the case to the association for further proceedings; or

"(B) if the Commission does not make any such finding, the Commission, by order, shall set aside the acting of the association and require the association to admit the applicant to membership therein or permit the person to be associated with a member, or, as appropriate, remand the case to the association for further proceedings.

"(4) Any person (other than a registered futures association) aggrieved by a final order of the Commission entered under this subsection may file a petition for review with a Untied States court of appeals in the same manner as provided in section 6(b) of this Act.".

REGISTERED FUTURES ASSOCIATION RULES

Sec. 9. Section 17(j) of the Commodity Exchange Act (7 U.S.C. 21(j)) is amended by striking out the third sentence.

LEVERAGE TRANSACTIONS

Sec. 10. Section 19 of the Commodity Exchange Act (7 U.S.C. 23) is amended to read as follows:

"Sec. 19. (a) Except as authorized under subsection (b), no person shall offer to enter into, enter into, or confirm the execution of, any transaction for the delivery of any commodity under a standardized contract commonly known to the trade as a margin account, margin contract, leverage account, or leverage contract, or under any contract, account, arrangement, scheme, or device that the Commission determines serves the same function or functions as such a standardized contract, or is marketed or managed in substantially the same manner as such a standardized contract.

"(b)(1) Subject to paragraph (2), no person shall offer to enter into, enter into, or confirm the execution of, any transaction for the delivery of silver bullion, gold bullion, bulk silver coins, bulk gold coins, or platinum under a standardized contract described in subsection (a) of this section, contrary to the terms of any rule, regulation, or order that the Commission shall prescribe, which may include terms designed to ensure the financial solvency of the transaction or prevent manipulation or fraud. Such rule, regulation, or order may be made only after notice and opportunity for hearing. The Commission may set different terms and conditions for transactions involving different commodities.

"(2) No person may engage in any activity described in paragraph (1) of this subsection who is not permitted to engage in such activity by the rules, regulations, and orders of the Commission in effect on the date of the enactment of the Futures Trading Act of 1986, until the Commission permits such person to engage in such activity in accordance with regulations issued in accordance with subsection (c)(2) of this section.

"(c)(1) Not later than 2 years after the date of the enactment of the Futures Trading Act of 1986, the Commission shall, with the assistance of a futures association registered under this Act, conduct a survey concerning the persons interested in engaging in the business of offering to enter into, entering into, or confirming the execution of, the transactions described in subsection (b)(1) of this section and shall transmit a report of the results of the survey to the Committee on Agriculture of the House of Representatives and the Committee on Agriculture, Nutrition, and Forestry of the Senate. Notwithstanding any other provision of law, for purposes of completing such report the Commission may direct, by rule, regulation, or order, a futures association registered under this Act to render such assistance as the Commission shall specify. Such report shall include the Commission's findings and any recommendations concerning—

"(A) whether such transactions serve an economic purpose;

"(B) the most efficient manner, consistent with the public interest, to permit additional persons to engage in the business of offering to enter into, entering into, and confirming the execution of such transactions; and

"(C) the appropriate regulatory scheme to govern such transactions to ensure the financial solvency of such transactions and to prevent manipulation or fraud.

"(2) Such repor[illegible]ll also include Commission regulations governing such transactions. Such re[illegible]ns shall provide for permitting additional persons to engage in such transac[illegible]s. Such regulations shall become effective on the expiration of 45 calendar days on which either House of Congress is in session after the date of the transmittal of such report to Congress. Such regulations—

"(A) may authorize or require, notwithstanding any other provision of law, a futures association registered under this Act to perform such responsibilities in connection with such transactions as the Commission may specify; and

"(B) may require that permission for additional persons to engage in such business be given on a gradual basis, so as not to place an undue burden on the resources of the Commission.

"(d) This section shall not affect any rights or obligations arising out of any transaction subject to the provisions of this section, as in effect before the date of the

enactment of the Futures Trading Act of 1986, that was entered into, or the execution of which was confirmed, before the date of the enactment of such Act.".

BRIEF EXPLANATION

H.R. 4613, The Futures Trading Act of 1986, will reauthorize appropriations to carry out the regulatory program under the Commodity Exchange Act, and make several technical improvements to that Act.

In brief, the major provisions of the bill, as ordered reported by the Committee, would—

(1) reauthorize appropriations for the Commodity Futures Trading Commission for three years (sec. 7);

(2) make technical amendments to the Act to clarify that the Act prohibits fraud in connection with any futures contract, regardless of whether executed on a contract market (sec. 2);

(3) require the Commission, within 90 days after enactment of the bill, to rescind its options pilot program and establish a permanent program for commodity options trading on contract markets (sec. 3);

(4) expressly authorize the Commission (on a majority vote of the Commissioners) to serve investigatory subpenas on persons outside the United States (sec. 4);

(5) authorize the Commission to seek appointment of a temporary ex parte receiver when it seeks—in connection with an action to force compliance with the Act—an ex parte freeze on assets or records to prevent the assets from being dissipated or the records destroyed (sec. 5);

(6) permit Commission employees and Commissioners to invest in actual commodities so long as no nonpublic information is used and the transactions do not involve futures, options, or leverage, and authorize the Commission to permit, by regulation, other transactions by Commissioners or employees (sec. 6);

(7) simplify and clarify the procedures for Commission review of disciplinary actions and membership restrictions imposed by registered futures associations (sec. 8);

(8) delete from the Act a provision that requires the Commission to complete initial action on registered futures association rules within 30 days (sec. 9); and

(9) with regard to leverage transactions—

(a) prohibit all leverage contracts except gold, silver, coin, and platinum contracts;

(b) temporarily prohibit the entry of new firms into the leverage business until the survey and report described in (c) and (d) below are completed;

(c) require the Commission to conduct a survey concerning the firms interested in entering the leverage business;

(d) require the Commission to report to Congress, within two years, on—

(i) the results of the survey;

(ii) whether leverage transactions serve an economic purpose;

(iii) the most efficient manner, consistent with the public interest, to permit new entries into the business; and

(iv) the appropriate leverage business regulatory scheme to ensure financial solvency and prevent manipulation or fraud;

(e) require that the report described in (d) above also include regulations governing the leverage business, which—

(i) must provide for permitting additional firms to enter the business;

(ii) could provide for a registered futures association to perform leverage regulatory functions; and

(iii) could provide for permitting new entries into the business on a gradual basis, so as not to place an undue burden on the Commission; and

(f) require that the regulations described in (e) above go into effect at the end of 45 days of congressional session after they are transmitted (sec. 10).

PURPOSE AND NEED

I.

The Commodity Futures Trading Commission, under the Commodity Exchange Act, regulates one of the most dynamic and complex areas of the national economy. Futures trading, growing out of its agricultural origins, now is a risk-sharing endeavor used not only by traders and dealers in traditional hard commodities, but also by the world's largest banks, investment firms, and pension funds as an essential financial management tool.

New trading instruments or contracts have attracted major new market participants, resulting in an almost sevenfold increase in futures and options trading activity in the past 10 years. Pension fund managers now hedge some of their securities market risks using stock index futures, bankers and other commercial enterprises are able to hedge borrowing and lending risks with a wide variety of interest-rate-sensitive contracts, and international businessmen can lower the risk of currency exchange rate fluctations through the use of currency futures. Futures trading has long assisted farmers, agribusinesses, food companies, and precious metals dealers and users to be more efficient and market sensitive.

Hedging or risk shifting is one of the economic purposes of the futures markets. The other major function is commodity price discovery. When buyers and sellers of a commodity, both hedgers and speculators, come together at an exchange, the forces of supply and demand are able to determine market prices only for the moment, but trading in contracts that do not expire for many months gives an indication of current thinking about the future price of a commodity.

The regulation of this complex, aggressive, and fast-paced industry is a difficult job. This Committee was instrumental in creating the Commodity Futures Trading Commission in 1974, and has followed its progress closely through personal contact, public hearings, and periodic reports from the Chairman of the Commission.

The Committee is pleased to note that the Commission has continued to mature in its regulatory role and judgment as the futures industry has grown in its volume and complexity. Dr. Susan Phillips has given outstanding leadership to the Commission and its staff since becoming Chairman in 1983.

The Committee notes that the Commission continues to function as an effective regulator with increasing responsibilities while at the same time accomplishing its goals within a very modest budget, requiring skillful management of its resources. The Commission has been able to meet the challenge of its growing responsibilities by increasing productivity, automating certain operations, streamlining programs, encouraging State authorities to bring enforcement actions against fraudulent commodities operators, and delegating certain functions to industry self-regulatory organizations.

During fiscal year 1985, there was a steady, across-the-board improvement in the enforcement of commodities law. In the course of the year, the Commission instituted 18 injuctive actions, the highest number of such actions since fiscal 1980, and placed more than $9 million of customer funds and assets under the protection of equity receivers.

The Commission also instituted 51 administrative enforcement proceedings during 1985, and litigation of various administrative actions resulted in the suspension, revocation, or denial of 53 registrations. Civil monetary penalties of $2.8 million were imposed on 86 individuals or firms; 101 individuals or firms were subject to cease and desist orders; and 54 individuals or firms were prohibited from trading on contract markets.

The Commission regulates the activities of 13 U.S. exchanges, 393 brokerage houses (futures commission merchants), 53,000 Commission-registered salespeople, 6,000 floor brokers, 1,200 commodity pool operators, and 2,100 commodity trading advisors. In fiscal year 1985, almost 170 million futures contracts and options were traded on U.S. exchanges, compared to 26 million ten years before.

To meet its responsibility for ensuring the financial integrity and fairness of the futures markets, the Commission reviews the terms and conditions of proposed futures contracts, registers companies and individuals who handle customer funds or give trading advice, and approves exchange rules, such as those that require customer funds to be kept in accounts separate from those maintained by firms for their own use and require such customer accounts be marked to present market value at the close of each trading day.

Based in Washington, D.C., the Commission maintains regional offices in Chicago and New York, cities with ten futures exchanges between them, and it has smaller, more specialized regional offices in Kansas City and Los Angeles and a suboffice of the Chicago regional office in Minneapolis.

The agency's five Commissioners are appointed by the President. They serve for staggered five-year terms, with one designated by the President with the consent of the Senate to be Chairman. No more than three Commissioners at any one time can be from the same political party.

Regulation of futures trading, however, is not solely vested with the Commission. Each of the 13 exchanges are charged with important self-regulatory responsibilities over their members' trading activities. Similarly, the National Futures Association, established in 1981 and funded by the industry itself, performs many important regulatory duties relating to off-exchange functions and activities.

Commodities exchanges have long performed regulatory functions to ensure integrity of the marketplace and fair dealing on the part of their members. The exchanges have established rules of order and conduct as well as the authority to fine or suspend members. The Commission not only monitors the exchanges' activities on a continuous basis with on-site personnel but also conducts periodic exchange rule enforcement reviews to determine the effectiveness of exchange self-regulation. This procedure has proven over the decades to provide effective, but not overburdensome, regulation of these fast-paced markets.

The National Futures Association, on the other hand, is a new institution that has made significant strides in meeting the requirements established in the Futures Trading Act of 1982. Some of the duties and responsibilities required of or delegated to the NFA include:

(1) registration of a variety of categories of industry participants;
(2) establishment of training standards and proficiency testing for industry professionals;
(3) financial auditing and surveillance of futures commission merchants;
(4) establishment of sales practice standards and regulations; and
(5) establishment of arbitration and disciplinary programs.

Based on information received directly from the NFA, and on a required report submitted to Congress by the Commission in December 1985, the Committee believes the NFA is making good progress toward the goals established for it. Further, the Committee recognizes that the industry itself has contributed $17 million in dues to the NFA fund, thus to some extent lessening the pressure to increase appropriations for the Commission.

The statutory authorization for appropriations to cover the Commission's regulatory program under the Act will expire on September 30, 1986. In addition, the Committee has received testimony proposing several amendments to the Act, mostly technical in nature. The various issues—including the need for reauthorization—addressed by the Committee-reported bill are as follows:

Section 4b prohibition of fraud in all futures contracts

The Committee bill would make a technical amendment to section 4b of the Commodity Exchange Act, which generally prohibits any person from cheating or defrauding any other person "in or in connection with any order to make, or the making of, any contract of sale of a commodity for future delivery, made, or to be made, on or subject to the rules of any contract market * * *." The proposed amendment would delete the phrase, "on or subject to the rules of any contract market," making the antifraud provision of section 4b expressly applicable to any commodity futures transaction, regardless of whether executed on or subject to the rules of a contract market.

Several courts have entered injunctions against violations of section 4b in cases brought by the Commission involving the off-exchange sale of futures contracts. Nonetheless, the current language of section 4b could be interpreted narrowly to limit its authority to exchange-traded futures, resulting in a court's refusal to apply section 4b to the sale of off-exchange futures contracts. The proposed amendment would simply codify the Commission's interpretation of section 4b and make it consistent with other antifraud provisions of the Act and Commission rules, which are not limited to transactions conducted on a contract market.

The amendment would not expand the Commission's jurisdiction. State regulators are encouraged to play an active role in stopping off-exchange fraud operations from doing busienss in their States. Under the leadership of Commissioner Fowler West, significant progress has been made in Commission cooperation with State securities administrators and State attorneys general. This amendment would simply make it clear that both the Commission and the State have the authority to prosecute fraud committed by off-exchange operators.

Extraterritorial service of subpenas

The bill would amend section 6(b) of the Act specifically to authorize the Commission to serve investigatory and other administrative subpenas on persons outside the territorial United States. The proposed change is necessary because, in a recent decision (*CFTC* v. *Nahas,* 738 F.2d 487 (D.C. Cir. 1984)), the U.S. Court of Appeals for the District of Columbia Circuit ruled that section 6(b), as presently drafted, does not authorize enforcement of an investigatory subpena served on a foreign citizen in a foreign country.

In the course of its investigation of events in the U.S. silver market during 1979 and 1980, the Commission had cause to believe that one of the principal participants in the market was Naji Robert Nahas, a dual citizen of Brazil and Lebanon, then residing in Brazil. In 1983, the Commission issued a subpena directing Nahas to appear with his records of relevant transactions at the Commission's offices in Washington, D.C. The subpena was served on Nahas in Sao Paulo, Brazil. The Commission, at the suggestion of the U.S. Department of State, had retained a Brazilian attorney to serve the subpena. When Nahas failed to respond to the subpena, the Commission filed suit in the U.S. District Court for the District of Columbia to enforce the subpena. When Nahas failed to comply with the court's order enforcing the subpena, the court found Nahas in contempt. However, the U.S. Court of Appeals for the District of Columbia Circuit later overturned the district court's decision, holding that section 6(b) of the Act did not authorize enforcement of an investigatory subpena served on a foreign citizen in a foreign country. The appeals court did not question the authority of Congress to so authorize the Commission, but rather ruled that Congress had not granted such authority when it enacted section 6(b).

If allowed to stand, the Court of Appeals ruling might foreclose the Commission from investigating the conduct of foreign market participants, regardless of the magnitude of their involvement in U.S. markets, so long as they, or other witnesses, remain outside the territorial United States. Under this ruling, even though a foreign participant's conduct is clearly subject to the requirements of the Act, and despite the existence of sufficient contacts with the United States to establish in personam jurisdiction as a matter of due process, the foreign participant may only be subject to the Commission's subpena power in service can be made in the territorial United States.

The amendment made by the bill would simply provide for treatment under the law for noncitizens equal to that applied to citizens.

Statutory authority to obtain ex parte appointment of receiver

Section 6c of the Act authorizes the Commission on an ex parte basis to obtain a restraining order to freeze the assets of persons it believes have engaged in or are about to engage in a violation of the Act or Commission rules, and to prevent such persons from destroying books and records. As the section is presently written, there is no express power for the court to appoint a receiver on an ex parte basis to protect and manage the property of the entity subject to the freeze order. The bill would amend section 6c to authorize the ex parte appointment of a temporary receiver pending a hearing to decide whether a permanent receiver should be appointed or such other hearing as the court may order.

In many instances in which the Commission takes enforcement action against an off-exchange operation, the Commission will seek to obtain an ex parte restraining order to protect books and records and to freeze the operation's assets, but no independent person is in place to ensure that the books and records and assets are protected, and in some cases, to preserve assets by making day-to-day business decisions until a permanent receiver can be appointed. In at least one instance, it is believed that a defendant disposed of books and records and transferred assets after an ex parte order was issued.

Often, the period between issuance of the ex parte restraining order and the hearing on the application for appointment of a receiver can be as long as 15 to 20 days. During that time, the business operation subject to the order may hold open positions in the futures market that would go unmanaged or be liquidated for failure to meet a margin call. In addition, while assets are frozen, employee salaries may go unpaid and employees may quit, further limiting the ability of the operation to preserve any assets it may have. A temporary receiver could pay salaries and other legitimate expenditures, meet margin calls or liquidate unprofitable positions, and otherwise protect the assets of the operation for ultimate distribution to customers.

Futures Association disciplinary actions

The National Futures Association's disciplinary system for violations of its rules by members or their associated persons includes a summary procedure called a "member responsibility action" (MRA), which is used by the NFA to obtain expeditious compliance with its rules and provide immediate protection to customers. The Commission generally regards the MRA as a powerful and appropriate tool for self-regulatory bodies such as the NFA to obtain immediate compliance. However, an impediment to the effective use of the MRA procedure—and to the NFA's disciplinary program as a whole—results from the provisions of section 17(h) of the Act.

Specifically, section 17(h) presently provides that any person who is the subject of a registered futures association disciplinary action may appeal that action to the Commission, automatically staying the effectiveness of the action. The Commission can lift the stay, but only after providing notice and opportunity for a hearing, which may consist solely of affidavits and oral argument. As a result, the effectiveness of NFA's MRA procedure—which, by its very nature, is designed for use where immediate action is necessary to protect the markets, customers, or other NFA members—can be dramatically reduced. Similarly, the effectiveness of any sanctions imposed as a result of formal NFA disciplinary procedures are likely to be diminished if a suspended or expelled member can forestall the result merely by filing an appeal with the Commission.

The bill, therefore, would amend section 17(h) to eliminate the automatic effect of the stay provisions of that section, with the Commission required to establish procedures for expedited consideration and determination of the question of a stay. The amendment would make the stay provisions applicable to the NFA's member responsibility actions parallel to those for futures exchanges' disciplinary actions.

Commission review of Futures Association actions

Under the Committee bill, sections 17(h) and 17(i) of the Act would be amended to make explicit that Commission review of registered futures association disciplinary actions is available only for final actions, precluding the disruption of the NFA disciplinary process by untimely appeals to the Commission and, ultimately, the courts. Further, it would amend section 17(i) expressly to authorize the Commisssion to review only the record before an association and the submisssions of the parties. The actual standards for Commission review of any association decision, however, would remain essentially unchanged.

Additionally, the bill would amend section 17(i)(3), which deals with denial of membership in a futures association and with bars to association with a member, to make the standards for Commission review of an association decision similar to those governing association disciplinary actions.

Certain prohibited transactions

Section 9(d) of the Act makes it a felony for a Commissioner or Commission employee to participate, directly or indirectly, in commodity futures, option, or leverage transactions or, with certain limited exceptions, in investment transactions in an actual commodity. In view of the vast increase, in recent years, in types of commodities on which futures contracts are traded, the bill would amend section 9(d) to ease some of these restrictions. The amendments are designed to enable the Commission to administer section 9(d) flexibility and ensure that transactions that do not pose any conflict of interest concerns are not subject to the broad prohibitions contained in the present law. The amendments also should obviate the need for further amendments to section 9(d) in the future, as the commodity markets continue to expand into new areas.

The amendment to section 9(d) would limit the restrictions on investment transactions in actual commodities to cover only those transactions that involve the use of nonpublic information or that are effected by means of a Commission-regulated instrument, such as a commodity futures or commodity option contract. Investment transactions in actual commodities permitted under existing law would continue to be permitted under the proposed amendments.

The amendment is consistent with congressional revisions enacted in 1982. At that time, Congress amended section 9(d) to permit Commissioners and employees to invest in U.S. Government securities, certificates of deposit, or similar financial instruments, so long as no nonpublic information is used and the transaction is not effected by an instrument regulated by the Commission. In the Committee's view, there is no reason why the philosophy underlying this 1982 amendment should not apply to investments in other commodities. So long as nonpublic information is not used and the commodity options or futures markets are not employed, the conflict of interest concerns underlying section 9(d) are greatly diminished and the Commission's employees should be able to invest in actual commodities.

However, the bill also would prohibit those investment transactions in actual commodities or instruments specified by Commission rule. This provision is necessary to enable the Commission to adopt rules to avoid the appearance of conflicts of interest in certain instances. For example, various stock indexes are the subject of both futures contracts and options on futures contracts. Investment in these indexes would still be prohibited if effected through commodity futures and options contracts, since these are instruments regulated by the Commission. Some of these indexes, however, also underlie options traded on national securities exchanges, and it is questionable whether it would be appropriate to permit Commission employees to acquire an interest in these stock indexes by use of instruments that resemble Commission-related options.

Additionally, the bill would empower the Commission to develop appropriate exceptions to the absolute restrictions against participation in futures and options transactions. These exceptions, such as to permit modest holdings in large mutual funds that hedge their portfolios in the futures market, would be made only when the Commission determines that such investments would pose no conflict of interest concerns and otherwise must be consistent with congressional intent in enacting section 9(d). Of course, notwithstanding the adoption of any such exceptions that would permit Commission personnel to engage in such transactions, all Commissioners and employees would continue to remain subject to the criminal provisions of section 9(e) of the Act, which bars Commissioners and employees from divulging to any market participant confidential information that may affect market prices.

Three-year reauthorization

Section 12(d) of the Act authorizes the appropriation of such sums as are required to carry out the provisions of the Act through the fiscal year ending September 30, 1986. The bill would extend the authorization for appropriations for three years, through the fiscal year ending September 30, 1989.

The Committee adopted this relatively shorter reauthorization period for the convenience of scheduling congressional business and activities, and the decision is not a reflection of dissatisfaction with the Commission. The normal four-year authorization period would have expired in 1990, coinciding with the expiration of the Food Security Act of 1985. This would have resulted in two major legislative efforts ongoing simultaneously and stretched the resources of the Committee. Further, the Committee feels that with the rapid changes taking place in the industry the shorter period would be appropriate.

Leverage transactions

The Committee bill contains an amendment that substantially revises section 19 of the Act, which deals with leverage transactions. As revised, section 19 will (1) ban, after date of enactment, new leverage transactions on all commodities except silver, gold, and platinum, and (2) temporarily prohibit the entry of new firms into the leverage business until the survey and report described below are completed.

Additionally, the bill will require the Commission, with the assistance of a registered futures association, to conduct a survey concerning persons interested in engaging in the business of leverage transactions and report to Congress, within two years, the results of the survey.

The report to Congress would also include the Commission's findings and any recommendations concerning—

(1) whether leverage transactions serve an economic purpose;

(2) the most efficient manner, consistent with the public interest, to permit additional persons to engage in the leverage business; and

(3) the appropriate regulatory scheme to govern leverage transactions to ensure the financial solvency of the transactions and prevent manipulation or fraud.

The report would include Commission regulations governing leverage transactions, which must permit additional persons to engage in leverage transactions. The regulations would become effective on the expiration of 45 calendar days in which either House of Congress is in session after the date of the transmittal to Congress. The regulations could authorize or require a registered futures association to perform regulatory responsibilities in connection with leverage transactions, and could require that permission for additional persons to engage in the leverage business be made on a gradual basis so as not to place an undue burden on the resources of the Commission.

The Commission was given exclusive jurisdiction to regulate gold and silver leverage transactions by the Commodity Futures Trading Commission Act of 1974. In 1978, Congress added section 19 to the Act. In this section, Congress banned leverage transactions in agricultural commodities, authorized the Commission to prohibit certain leverage transactions, and extended the Commission's exclusive jurisdiction to leverage transactions in all other commodities.

Between 1974 and 1982, the Commission adopted two moratoria on the entry of persons into the leverage transaction business and a broad antifraud rule applicable to leverage transactions.

The Futures Trading Act of 1982 directed the Commission to regulate leverage transactions in gold and silver bullion and bulk coins and in other commodities, except those subject to the 1978 prohibition on leverage transactions in agricultural commodities.

As a result of the direction given by Congress in 1982, the Commission issued interim final leverage regulations in 1984 and 1985 applicable to both long and short leverage transactions in gold and silver bullion and coins, copper, platinum, and certain foreign currencies. Two firms have been registered as leverage transaction merchants under these regulations.

This Committee has on numerous occasions since 1974 expressed its concern that the Commission was moving too slowly in bringing leverage trading under Federal regulation. The Committee congratulates Chairman Phillips for her attention to congressional intent in the Futures Trading Act of 1982 in implementing a complete set of strong Federal regulations.

The issue of how to deal with leverage trading has been difficult for the Committee. Amendments that would have banned leverage contracts, or revoked exclusive Commission regulation of leverage, or redefined leverage transactions as futures contracts, thereby requiring that they be traded on exchanges, were rejected. The Committee opposed any change in the law that would have had the unfair effect of putting two Commission registered and regulated leverage firms out of that business. Another alternative would have been to grant a permanent monopoly to these two firms, but this option would be unfair to other persons who would want to enter the business and would be anticompetitive.

The Committee bill is a compromise that neither puts legitimate businessmen out of business, nor codifies an anticompetitive monopoly for these businessmen. It would limit leverage trading to gold, silver, and platinum, and it would pave the way to turn over much of the regulation to a registered futures association that would be industry-funded.

Termination of pilot status of options trading

The Committee bill contains an amendment to section 4c of the Act to terminate, within 90 days after the date of enactment, the pilot status of the program for the trading of commodity options. The amendment would make permanent the program of exchange-traded commodity options, which is now operated on a pilot basis, and remove any restrictions on the number of Commission-approved commodity options contracts that can be traded on exchanges.

On November 3, 1981, the Commission published final rules establishing a strictly controlled, three-year pilot program to permit exchange-traded commodity options. Initially, the pilot program permitted each exchange to trade one option on a commodity futures contract involving other than domestic agricultural commodities. In September 1982, the Commission designated the first options under the pilot program—options on sugar, gold, and Treasury bond futures.

After careful monitoring and evaluation, the Commission expanded the pilot program, eventually permitting each exchange to trade up to eight options, including up to two options on physical commodities. At the time of Committee consideration of the bill, sixteen options had been designated to trade under the pilot program, including in addition to those initially approved, options on stock index, silver, Treasury note, Eurodollar, foreign currency, and cocoa futures contracts, and options on gold and Eurodollar physicals.

In the Futures Trading Act of 1982, the Congress repealed the 1936 statutory ban on options involving domestic agricultural commodities, and a separate three-year pilot program for the trading of options on those commodities was adopted by the Commission on January 23, 1984. Under the pilot program, each exchange could be designated for two options on domestic agricultural futures contracts and the first contracts began trading in October 1984. Currently, ten options, covering the grains, livestock, cotton, and frozen concentrated orange juice, are trading under this pilot program.

The Committee's amendment coincides with a recent decision by the Commission to terminate the pilot status of the program for trading options on futures contracts other than those on domestic agricultural commodities and make the trading of such options permanent. In addition, the Chairman of the Commission testified during hearings on the bill that the Commission currently has under consideration whether a further expansion of the agricultural options program is warranted.

The Committee believes the Commission has practiced good judgment in its regulation and oversight of both the agricultural and the nonagricultural options programs. Furthermore, the Committee is satisfied that the overall experience with both of these pilot programs indicates that few regulatory problems have arisen, and that the exchanges have discharged their responsibilities adequately. Additionally, the Commission has detected no adverse effects on the underlying futures markets resulting from such option trading.

Conclusion

The Committee-reported bill will make several amendments to the Act to strengthen and improve the futures, options, and leverage regulatory programs of the Commission under the Act. In addition, the bill provides the necessary reauthorization of appropriations to cover the costs of the regulatory activities of the Commission. It is sound legislation that should be enacted.

SECTION-BY-SECTION ANALYSIS

Section 1—Short title

Section 1 provides that the bill may be cited as the "Futures Trading Act of 1986".

Section 2—Fraudulent practices

Section 2 will amend section 4b of the Commodity Exchange Act, which (in the first sentence) makes unlawful fraud, false statements, bucketing, and other fraud-related practices in connection with futures contracts. (NOTE.—The second sentence of section 4b states that the proscriptions in the first sentence and the other provisions of the Act may not be construed to prevent certain cross-trading.) Section 9(b) of the Act makes any knowing violation of section 4b a felony, and other provisions in the Act provide for State action, civil penalties, and private rights of action for violations of the Act.

As currently written, the first sentence of section 4b proscribes fraud-related practices in connection with futures contracts "made, or to be made, on or subject to the rules of any contract market * * *"

Section 2 will strike the words "on or subject to the rules of any contract market" to clarify that the section 4b proscription against fraud-related practices in connection with futures contracts applies to *all* futures contracts regardless of whether they are executed on a contract market. (NOTE.—While section 4(a) of the Act requires that all futures contracts be executed on a contract market, persons could illegally try to purvey off-exchange futures contracts.)

Section 2 also will add a new sentence to section 4b, to exempt from the antifraud proscriptions in the first sentence, as amended, as well as the second sentence, any activity that occurs on a foreign board of trade, exchange, or market (or clearinghouse for the board of trade, exchange, or market) involving any commodity futures contract made on or subject to the rules of the foreign board of trade, exchange, or market. The exemption will clarify that any antifraud enforcement action brought under section 4b, as revised by section 2, involving foreign futures contracts will not be directed at the rules of, or trading practices occurring on, foreign boards of trade, exchanges, or markets, or at the terms or conditions of the futures contracts traded on such boards of trade, exchanges, or markets. The Committee understands that activities on certain foreign markets include kerb trading or after-hours trading and intends that this trading be included in the exemption from the enforcement provisions of section 4b.

The exemption will not apply to fraudulent activities that, while subject to the rules of an exchange, do not take place on an exchange. For example, many foreign exchanges have rules proscribing fraud in the solicitation of futures contracts. If section 4b did not reach such conduct, persons could commit fraud on U.S. citizens, for example, by accepting customer funds with no intention of transmittting the money to execute contracts on the foreign exchange, and the fraud arguably could not be prosecuted under section 4b. Under section 2, such conduct will be subject to both civil and criminal prosecution under section 4b.

Section 3—Options transactions

Section 3 will strike out the current text of subsection (c) of section 4c (commodity options) of the Commodity Exchange Act and substitute a new text.

The text of subsection (c) that would be repealed contains the following provisions:

(1) A prohibition against nonagricultural commodity options transactions—except dealer options (which specifically are provided for in subsection (d) of section 4c)—until the following conditions are satisfied: (a) the Commodity Futures Trading Commission transmits evidence to the agriculture committees of Congress of its ability to regulate successfully these transactions (including a copy of the proposed regulations); and (b) 30 days of continuous session of Congress elapse following transmission of the justification statement by the Commission. (NOTE.—Current subsection (c) specifies the type of options covered here as options involving "any commodity regulated under this Act but not specifically set forth in section 2(a) of this Act prior to the enactment of the Commodity Futures Trading Commission Act of 1974". The commodities specifically set forth in section 2(a) prior to the 1974 amendment are all agricultural commodities, and options on those enumerated commodities are referred to here as agricultural commodity options.)

(2) With respect to agricultural commodity options, authorization for the Commission to conduct a pilot program of trading in such options for a period of not to exceed three years. The pilot program can permit options trading in as many commodities as would provide an adequate test of such trading. After completion of the pilot program, the Commission can permit trading in agricultural options, without regard to the pilot program restrictions, after (a) the Commission transmits, to the agriculture committees of Congress, evidence of its ability to regulate successfully these transactions (including a copy of the proposed regulations), and (b) the expiration of 30 days of continuous session of Congress following transmission of the justification statement.

(3) Authority for the Commission to transmit, at any time, documentation of its ability to regulate option transactions regarding individual commodities, classes of commodities, or regulation of options trading on specific boards of trade.

(4) A provision stating that obligations arising out of any commodity options transaction that was entered into, or the execution of which was confirmed, before October 1, 1978, are not affected by the provisions of subsection (c) described above.

(5) A provision stating that the subsection (c) prohibitions described above are not to apply to any transaction, expressly permitted under Commission regulations, in which the purchaser is a producer, processor, or commercial user of, or a merchant handling, the commodity involved in the transaction, or products thereof (trade options). (NOTE.—Trade options are not traded on exchanges and are purchased by commercial entities in connection with their business activities.)

The effect of the repeal of these provisions is to lift the restrictions on commodity options trading contained therein. However, the Commission would retain its general authority, under subsection (b) of section 4c, to prohibit or otherwise place restrictions on commodity options transactions. The Committee does not intend that section 3, by repealing the trade options exemption, will make any change in the existing law that allows trade options.

In addition to repealing the limitations on options trading, and exemptions thereto, described above, section 3 will substitute a new text for subsection (c) that will require the Commission—within 90 days after enactment of the bill—to issue regulations to—

(1) eliminate the pilot status of the program for the trading of commodity options on contract markets, including any numerical restrictions on the number of commodities or option contracts for which a contract market may be designated; and

(2) otherwise continue to permit the trading of such commodity options under such terms and conditions that the Commission, from time to time, may prescribe.

(NOTE.—In addition to the requirement, under current subsection (c), for agricultural commodity options trading to be conducted on a pilot basis, the Commission until recently also had chosen to allow nonagricultural commodity options trading only on a pilot basis. The Commission, on April 29, 1986, however, voted to lift the pilot status for nonagricultural options trading, an action that is consistent with the provisions of the new text of subsection (c), as described above.)

Section 4—Extraterritorial service of subpenas

Section 4 will amend the third and fourth sentences of subsection (b) of section 6 of the Commodity Exchange Act. The third through eighth sentences of subsection (b) grant the Commodity Futures Trading Commission certain investigatory powers to enforce the Act. Specifically, the third sentence provides that, for the purpose of securing effective enforcement of the Act and for the purpose of any investigation or proceeding under the Act, any member of the Commission, or any administrative law judge or other officer designated by the Commission, may administer oaths and affirmations, subpena witnesses, compel their attendance, take evidence, and require the production of any records that the Commission deems relevant or material to the inquiry. Under the fourth sentence, the attendance of witnesses and the production of records at any designated place of hearing can be required from any place in the United States. The fifth through eighth sentences provide as follows: In case of contumacy by, or refusal to obey a subpena issued to, any person, the Commission can invoke the aid of any court of the United States within the jurisdiction of which the investigation or proceeding is conducted, or where the person resides or transacts business, in requiring the attendance and testimony of witnesses and the production of records; the court can issue an order requiring the person to appear before the Commission or Commissioner, or administrative law judge or other officer designated by the Commission, to produce records (if so ordered) or to give testimony touching the matter under investigation or in question; any failure to obey the court order can be punished by the court as a contempt thereof; and all process in any such case can be served in the judicial district in which the person is an inhabitant or transacts business, or wherever the person may be found.

Section 4 will amend the fourth sentence of subsection (b) to add provisions that—

(1) grant the Commission the power to compel the attendance of witnesses and the production of records, at a designated place of hearing, from any foreign country or jurisdiction; and

(2) authorize the service of a subpena issued under subsection (b) on any person who is not to be found within the territorial jurisdiction of any court of the United States in such manner as the Federal Rules of Civil Procedure prescribe for service of process in a foreign country, except that a subpena to be served on a person who is not to be found within the territorial jurisdiction of any court of the United States could be issued only on the prior approval of the Commission.

Section 4 also would make a technical change in the third sentence of subsection (b) to conform it to the requirement added to the fourth sentence that an extraterritorial subpena could be issued only on the prior approval of the Commission.

In agreeing to explicitly grant authority to the Commission to serve investigatory subpenas on persons outside the United States, the Committee recognizes the importance of the Commission's ability to obtain information from foreign nationals who trade in U.S. markets. Such information is necessary for the Commission to perform its investigatory and surveillance responsibilities to ensure that the markets are safe for all participants, domestic and foreign. However, the Commission has assured the Committee that it will not use this authority routinely. (See the letter from Commission Chairman Phillips to Mr. Jones, dated May 1, 1986, printed in the Administration Views section of this report.)

The scope of the Commission's authority is intended to parallel the authority of the Department of Justice and the Federal Trade Commission to serve civil investigative demands abroad. Thus, for example, the Commission's use of the extraterritorial subpena power is to be limited to the pre-complaint, investigatory stage of enforcement proceedings. The Committee recognizes that, in any action to enforce a subpena issued under the new authority, the Federal district courts would give appropriate consideration to any due process defenses raised.

The Committee expects the Commission to exercise the new authority appropriately in light of pertinent international factors. The Commission has assured the Committee that it is sensitive to the issues raised by foreign governments and foreign exchanges with respect to this authority and that it desires to exercise the authority in a way that will take those concerns into consideration.

The Committee understands that the Commission traditionally has consulted with the Department of State, as it did in the *Nahas* case, to find a means of contacting foreign nationals in a way that seeks to avoid offending the foreign nation, and that the Commission intends to maintain that practice, where practicable. The Committee also understands that, where appropriate, the Commission will consult through the State Department with representatives of the receiving nation, with a view toward minimizing any perceived intrusion on the nation's sovereignty. In addition, where there are particular treaties or governmental mutual assistance guarantees, the Committee intends that the Commission use them, to the extent practicable.

Section 5—Ex Parte appointments of temporary receivers

Section 5 will add new provisions to the proviso to the first sentence of section 6c of the Commodity Exchange Act. Under the first sentence of section 6c, whenever it appears to the Commodity Futures Trading Commission that any contract market or other person—

(1) has engaged, is engaging, or is about to engage in any act or practice constituting a violation of the Act, or any regulation or order under the Act, or

(2) is restraining trading in any commodity for future delivery, the Commission can bring an action in Federal district court to enjoin the act or practice, or to enforce compliance with the Act or any regulation or order issued under the Act. Under current law, the proviso to the first sentence prohibits the courts from issuing ex parte orders in such cases, except for a restraining order that prohibits a person from destroying, altering, or disposing of records, or refusing to permit Commission representatives to inspect such records, or that prohibits a person from withdrawing, transferring, removing, dissipating, or disposing of any funds, assets, or other property.

The language to be added to the proviso to the first sentence will provide authority for ex parte orders supplemental to such ex parte restraining orders. Specifically, an ex parte order could issue for the appointment of a temporary receiver to administer any records, funds, assets, or other property that is subject to the restraining order and to perform other duties the court considers appropriate.

Section 6—Certain prohibited transactions

Section 6 will substantially revise subsection (d) of section 9 of the Commodity Exchange Act.

Under current law, subsection (d), in the first sentence, makes it a felony for any Commodity Futures Trading Commission Commissioner, or Commission employee or agent, to engage, directly or indirectly, in (1) any commodity futures, options, or leverage transaction, or (2) any investment transaction in an actual commodity (with certain exceptions contained in the second sentence). The penalty for a violation is a fine of not more than $100,000, imprisonment for not more than five years, or both, together with the costs of prosecution.

The second sentence, under current law, provides that the prohibition against investment transactions in actual commodities does not apply to—

(1) any purchase of agricultural commodities or livestock for use in the person's own farming or ranching operations, any sale of an agricutural commodity produced in connection with such farm or ranch operation, or any sale of livestock owned by the person for at least three months;

(2) any transaction of a trust established by the person but over which the person has no control, if the transaction (a) is only a hedge against adverse price change in connection with the person's farming or ranching operation, or (b) is a transaction for the lease of oil, gas, or other mineral rights owned by the person; or

(3) any purchase or sale (not by an instrument regulated by the Commission) of United States securities, certificates of deposit, or similar financial instruments if no nonpublic information is used by the person in the transaction.

The third sentence, under current law, provides that, with respect to the excepted transactions under the second sentence, the Commission must require Commissioners and its employees and agents who participate in such transactions to notify the Commission, and make such information available to the public.

Section 6 will make the following changes to subjection (d):

(1) It would make the prohibition, in the first sentence, against investment transactions in actual commodities applicable only if (a) nonpublic information is used in the investment, (b) the investment transaction is prohibited by rule or regulation of the Commission, or (c) the investment transaction is effected by means of any instrument regulated by the Commission (such as a futures contract).

(2) It would repeal the second sentence in conjunction with the new provisions added to the first sentence (described above), which will substitute for the exemptions to the actual commodity investment prohibition now contained in the second sentence.

(3) It would repeal the third sentence.

(4) It would add a new sentence to subsection (d) stating that the prohibitions contained in the first sentence, as amended, will not apply to any transaction or class of transactions that the Commission, by rule or regulation, determines would not be contrary to the public interest or othewise inconsistent with the purposes of section 9. This would empower the Commission to develop appropriate exceptions to the absolute prohibitions, in the first sentence, against participation in commodity futures, options, and leverage transactions.

Section 7—Reauthorization

Section 7 would amend subsection (d) of section 12 of the Commodity Exchange Act to authorize appropriations in such amounts as will be necessary to carry out the Act in each of the 1987 through 1989 fiscal years. Under current law, subsection (d) authorizes appropriations only through the end of fiscal year 1986.

Section 8—Registered Futures Association disciplinary actions and membership restrictions

Section 8 will amend subsections (h) and (i) of section 17 of the Commodity Exchange Act. Section 17, generally, provides for the registration of futures associations and the operations of registered associations.

Subsection (h)—Application for Commission review of adverse actions: Under current law, subsection (h) provides that, if an association registered under section 17—

(1) takes any disciplinary action against a member or person associated with a member,

(2) denies membership to a person, or

(3) bars any person from being associated with a member,

such action, denial, or bar will be subject to review by the Commodity Futures Trading Commission. The Commission can conduct the review on its own motion or on application by a person aggrieved by the action. An aggrieved person must file an application for review within 30 days after the action, denial, or bar or within such longer period set by the Commission. Application to the Commission for review, or the institution of review by the Commission on its own motion, operates as a stay of the action, denial, or bar until an order is issued after such review (the procedures for which are set out in subsection (i)), unless the Commission otherwise orders after notice and opportunity for hearing on the question of a stay (which hearing may consist solely of affidavits and oral arguments).

Section 8 would revise subsection (h) as follows:

(1) It will eliminate the requirement that, if an application for Commission review of the action, denial, or bar by the registered futures association is made or the Commission institutes review, the action is stayed until the review is completed and a Commission order is issued under subsection (i) unless the Commission otherwise orders after notice and opportunity for a hearing. As amended, subsection (h) will provide to the contrary: The application for, or institution of, review will *not* operate as a stay unless the Commission otherwise orders, *summarily* or after notice and an opportunity for a hearing on the question of a stay.

(2) It would add a new provision to subsection (h) to require the Commission to establish procedures for expedited consideration and determination of the question of a stay.

(3) It would make explicit that Commission review of association disciplinary actions will be available only with respect to final actions.

(4) It would add a provision specifically requiring that the association give notice of a final disciplinary action, denial, or bar to the person involved and file the notice with the Commission. The notice would have to be in the form, and contain the information, prescribed by the Commission, by rule or regulation, as necessary or appropriate in furtherance of the purposes of the Act. In connection with the notice requirement, the beginning of the 30-day period during which application for review must be made would be changed from the date the "action has been taken" to the date "such notice is filed with the Commission and received by the aggrieved person".

Subsection (i)—Commission review: Under current law, subsection (i), in paragraph (1), sets out the procedures for Commission review of adverse disciplinary actions taken by a registered futures association. In a proceeding to review a disciplinary action, if the Commission, after appropriate notice and opportunity for hearing, on consideration of the record before the association and such other evidence as it may deem relevant—

> (1) finds that the member or person has engaged in the acts or practices, or has omitted such acts, that the association has found him to have engaged in or omitted, and
>
> (2) determines that the acts or practices, or omission to act, are in violation of the rules of the association designated in the determination of the association,

the Commission, by order, must dismiss the proceeding unless it appears to the Commission that the action should be modified in accordance with paragraph (2), described below. The Commission also must determine whether the acts or practices prohibited, or the omission of any act required, by the rules of the association constitute conduct inconsistent with just and equitable principles of trade, and so declare. If it appears to the Commission that the evidence does not warrant the finding that the person committed or omitted the acts for which it is to be disciplined by the association, or if the Commission determines that the acts or practices the person is found to have been engaged in are not prohibited by the rules of the association, or that any act that the person is found to have omitted is not required by the rules, the Commission, by order, must set aside the action of the association.

Paragraph (2), under current law, provides that, if after appropriate notice and opportunity for hearing, the Commission finds that any penalty imposed on a member or person associated with a member is excessive or oppressive, having due regard to the public interest, the Commission, by order, must cancel, reduce, or require the remission of the penalty.

Paragraph (3), under current law, sets out procedures for Commission review of a denial of membership in an association or the barring of a person from being associated with a member. In a proceeding to review a denial or bar, if the Commission, after appropriate notice and hearing, and on consideration of the record before the association and such other evidence as it may deem relevant, determines that the specific grounds on which the denial or bar is based exist in fact and are valid under section 17, the Commission by order must dismiss the proceeding. Otherwise, the Commission, by order, must set aside the action of the association and require it to admit the applicant to membership, or permit the person to be associated with a member.

Section 8 will make the following changes in subsection (i):

(1) It would make explicit that Commission review of association disciplinary actions under paragraph (1) will be available only with respect to final actions.

(2) It would add provisions to paragraphs (1) and (3) that the hearing in any review case could consist solely of consideration of the record before the association and opportunity for the presentation of supporting reasons to affirm, modify, or set aside the sanction imposed, by, or action of, the association.

In a related change, the requirement, under current law, that there be a hearing before the Commission makes a determination in a denial or bar case under paragraph (3) would be changed to a requirement that there be "an opportunity for a hearing." Current law requires only an opportunity for a hearing in reviews of disciplinary actions under paragraph (1). Also, the current provision in paragraph (2) that there is to be "appropriate notice and opportunity for a hearing" prior to the Commission making a determination under paragraph (2) to revise a penalty would be changed to a provision that there be a "proceeding in accordance with paragraph (1)."

(3) It would delete the provisions currently in paragraphs (1) and (3) that the Commission determination in a review case is to be based on the record before the association and such other evidence that the Commission deems relevant.

(4) The paragraph (1) provision, under current law, that—as a condition for the Commission making a determination in a disciplinary action review case—the Commission must determine whether the rule violations on which the association's sanctions are based constitute conduct inconsistent with just and equitable principles of trade would be deleted. Another criterion for a determination—that the rules are, and were applied in a manner, consistent with the purposes of the Act—would be added.

Similarly, it would delete a criterion, in paragraph (3), for a determination in a denial or bar case—whether the specific grounds for the denial or bar are "valid under" section 17—and add two new criteria for such determination: (1) the denial or bar is in accordance with the rules of the association, and (2) the rules are, and were applied in a manner, consistent with the purposes of the Act.

(5) It would add provisions to paragraphs (1) and (3) authorizing the Commission to dispose of a review case by remanding the case to the association for further proceedings.

(6) It would add a new paragraph (4) to subsection (i) to authorize any person (other than a registered futures association) aggrieved by a final order of the Commission under subsection (i) to file a petition for review with a U.S. court of appeals in the same manner as provided in subsection (b) of section 6 of the Act. (NOTE.—The eleventh through thirteenth sentences of subsection (b) of section 6 provide that, after a Commission order under subsection (b) is issued, the person against whom it is issued can obtain a review of the order (or such other equitable relief as the court deems just) by filing a written petition to set aside the order in the U.S. court of appeals of the circuit in which the petitioner is doing business. The petition must be filed within fifteen days after the notice of the order is given to the person. A copy of the petition must be transmitted by the clerk of the court to the Commission, and the Commission must file in the court the record in the case, as provided in section 2112 of title 28 of the United States Code. On the filing of the petition, the court will have jurisdiction to affirm, set aside, or modify the order of the Commission; but the findings of the Commission as to the facts, if supported by the weight of evidence, will be conclusive.)

(7) It would make several technical and conforming changes to the text of subsection (i).

Section 9—Registered futures association rules

Section 9 will delete the third sentence of subsection (j) of section 17 of the Commodity Exchange Act.

Subsection (j) of section 17 requires each registered futures association to file with the Commodity Futures Trading Commission copies of any changes in or additions to the rules of the association, and such other information and documents as the Commission requires to keep current, or to supplement, the registration statement and documents filed under section 17. An association can make a rule change or addition submitted to the Commission effective ten days after receipt of the submission by the Commission unless, within the ten-day period, the association requests review and approval thereof by the Commission or the Commission notifies the association in writing of its determination to review such rule for approval.

The third sentence of subsection (j), which would be deleted, requires the Commission to approve a rule within 30 days after its receipt if Commission approval is requested, or withing 30 days after the Commission determines to review for approval unless the Commission notifies the association of its inability to complete such approval or review within such period of time.

(NOTE.—Not affected by the bill is the fifth sentence of subsection (j), which provides that, if the Commission does not approve or institute disapproval proceedings with respect to any rule within 180 days after receipt (or within such longer period of time as the association may agree to), or if the Commission does not conclude a disapproval proceeding with respect to any rule within one year after receipt (or within such longer period as the registered futures association may agree to), the rule may be made effective by the association until such time as the Commission disapproves the rule.)

Section 10—Leverage transactions

Section 10 will substantially revise section 19 of the Commodity Exchange Act, which deals with leverage transactions.

Under current law, section 19, in subsection (a), prohibits leverage transactions involving commodities specifically set forth in section 2(a) of the Act prior to enactment of the Commodity Futures Trading Act of 1974, i.e., agricultural commodities, and describes what a leverage contract is. Subsection (b), under current law, prohibits leverage contracts on gold, silver, or coins except in compliance with orders or regulations of the Commodity Futures Trading Commission designed to ensure the financial solvency of the transaction or to prevent manipulation or fraud. Subsection (c), under current law, requires the Commission to regulate leverage transactions, but authorizes the Commission to prohibit any leverage transaction not permitted by Commission regulations in effect on December 9, 1982, if the Commission determines that it would be contrary to the public interest. Also, the Commission can set different terms and conditions for leverage contracts involving different commodities.

Under subsection (a), as rewritten by section 10, all leverage transactions would be prohibited, except those authorized under subsection (b), as rewritten. The current provisions of subsection (a) relating to agricultural commodity leverage transactions would be dropped as surplusage, given the broader prohibition on leverage transactions in the new text of subsection (a). However, the current language of subsection (a) describing leverage contracts would be retained.

Under section 10, the current provisions of subsections (b) and (c) of section 19 would be deleted and new provisions substituted therefor, as follows:

Paragraph (1) of subsection (b), as rewritten would prohibit any leverage transaction involving silver or gold bullion, bulk silver or gold coins, or platinum, except in compliance with the terms of Commission orders or regulations, including terms designed to ensure the financial solvency of the transaction or prevent manipulation or fraud. (NOTE: The effect of this provision and revised subsection (a) is to permit leverage contracts involving these commodities but no others. See also the description, below, of new subsection (d), which protects contracts that have already been entered into and involve other commodities.) Also, paragraph (1) would provide that (1) a Commission order or regulation could be made only after notice and opportunity for a hearing; and (2) the Commission could set different terms and conditions for leverage contracts involving different commodities.

Paragraph (2) of subsection (b), as rewritten, temporarily would restrict new entries into the leverage business. It provides that no person could deal in leverage contracts for the commodities listed in paragraph (1) who is not permitted to do so by Commission orders or regulations in effect on the date of enactment of the bill. However, paragraph (2) also provides that the bar on new entrants will remain in effect only until the Commission permits additional persons to deal in leverage contracts in accordance with regulations it will have to issue under subsection (c), as rewritten, within two years after the date of enactment of the bill.

Paragraph (1) of subsection (c), as rewritten, would require the Commission, not later than two years after the date of enactment of the bill, to—

(1) conduct (with the assistance of a futures association registered under the Act) a survey concerning the persons interested in entering the leverage business involving the commodities listed in subsection (b), as rewritten; and

(2) report the results of the survey to the agriculture committees of Congress.

For purposes of completing such report, the Commission could direct a registered futures association to assist it.

The report also would include the Commission's findings and any recommendations concerning—

(1) whether leverage transactions serve an economic purpose;

(2) the most efficient manner, consistent with the public interest, to permit additional persons to engage in the leverage business; and

(3) the appropriate regulatory scheme to govern leverage transactions to ensure the financial solvency of such transactions and prevent manipulation or fraud.

Paragraph (2) of subsection (c), as rewritten, will require that the report also include Commission regulations governing leverage transactions, and that such regulations provide for permitting additional persons to engage in leverage transactions. Paragraph (2) further would provide that the regulations will become effective on the expiration of 45 calendar days on which either House of Congress is in session after the date the report is transmitted to Congress. The regulations could—

(1) authorize or require a registered futures association to perform responsibilities, in connection with leverage transactions, specified by the Commission; and

(2) require that permission for additional persons to engage in the leverage business be given on a gradual basis, so as not to place an undue burden on the resources of the Commission.

Section 10 would add a new subsection (d) to section 19 to provide protection to leverage contracts in existence on the date of enactment of the bill. New subsection (d) provides that section 19, as rewritten, will not affect any rights or obligations arising out of any transaction subject to the provisions of section 19, as in effect before the enactment of the bill, that was entered into, or the execution of which was confirmed, before the date of enactment.

COMMITTEE CONSIDERATION

HEARINGS

The Subcommittee on Conservation, Credit, and Rural Development conducted public hearings in Washington, D.C., on March 18 and 19, 1986, to gather testimony concerning legislation to reauthorize appropriations for the regulatory program of the Commodity Futures Trading Commission under the Commodity Exchange Act.

Susan M. Phillips, Chairman of the Commodity Futures Trading Commission, presented the Commission's legislative requests, which include: clarification of the Commission's authority to prosecute fraud committed by off-exchange futures operators; express authority for the Commission to serve investigatory subpoenas on persons outside the territorial United States; statutory authority for the Commission to seek ex parte appointment of a receiver when an ex parte freeze of a firm's assets is sought; direct appeal of final Commission rules or orders to U.S. courts of appeals; elimination of Federal regulation of leverage transactions; elimination of automatic stay provisions that currently apply to disciplinary and related actions of registered futures associations being reviewed by the Commission; authority for the Commission to consider only the record before the association and submissions of parties in such reviews; authority to make the standards for Commission review of an association's decision to deny membership or association with an association member similar to the standards applied to disciplinary actions; authority for the Commission to alter or supplement registered futures association rules; conforming the association rule review process to the similar process governing other self-regulatory organizations; changes in the permissible investments for Commission personnel; and a six-year reauthorization of appropriations.

Robert K. Wilmouth, President of the National Futures Association, said the NFA, the only currently registered futures association, supports the Commission's proposals on automatic stays in reviewing association disciplinary and related actions, and refinement of the Commission's process of reviewing such actions. He said NFA does not support deletion of the present provision of law that requires the Commission to act on NFA rule proposals within 30 days and is strongly opposed to giving the Commission authority to alter or supplement NFA rules. Wilmouth opposed the Commission's position that its authority to alter NFA rules should equal its authority over exchange rulemaking by pointing out that NFA is not a contract market, and therefore, has different interests and congressional guidance

John F. Sandner, Chairman of the Board of the Chicago Mercantile Exchange, presented details of a computerized trade reconstruction system the exchange believes will enhance customer protection capabilities. He noted the costs to customers and damage to free markets that might result from the exchanges' interpretation of the Commission's audit trail rules. Sandner said that the Commission's proposed capital rules were promulgated without study of their consequences or benefits, and that the Commission had not consulted with industry experts or private consultants on the matter. Sandner also called for expansion of the option pilot program.

Alan J. Brody, President of the Commodity Exchange, Inc., described the collapse of Volume Investors, the futures firm that defaulted last year in the wake of heavy losses in positions concentrated in gold. Brody said the Commission's net capital rule proposed in the wake of the Volume collapse would not obviate the need for emergency action where positions become concentrated suddenly. He said customer account insurance, a matter currently under study by the National Futures Association, may not be a complete solution, either. The administrative costs, which ultimately would pass to customers, could exceed the amount of insurance paid to customers, he suggested. Brody stated that leverage contracts are really futures contracts, and urged strongly that they, therefore, should be regulated like futures.

John M. Damgard, President of the Futures Industry Association, called on the Commission to expand the option pilot program, particularly for agricultural commodities; explore a new definition of hedging appropriate for today's financial futures markets; increase speculative position limits; alter its aggregation policy; avoid interference with the interbank currency market and related financial transactions; and review exchange actions in disciplinary cases rather than reprosecuting exchange members.

Gary L. Seevers, Vice President of Goldman, Sachs and Company, stated that the Commission's definition of hedging needs to be revised and updated, in light of new financial futures and options markets. He said a new definition should reflect important and legitimate ways that financial institutions already are using these markets, and called for exemption of certain institutions from unnecessary registration as commodity trading advisers. Seevers said the Commission's policy on aggregation of positions also should be changed to avoid unwarranted constraints on the use of futures and options by institutional investors.

Theodore Thomte, President of the National Association of Futures Trading Advisors, said that NAFTA supports the Commission's proposal to eliminate the automatic stay provision currently applicable to registered futures association disciplinary and related actions, and that NAFTA also supports the Commission's proposal to make explicit that its antifraud authority extends to the marketing of illegal, off-exchange futures contracts.

James A. Layton, President of Clayton Brokerage Co. of St. Louis, Inc., called for expansion of the Commission's option pilot program. Layton said he had found that all the options traded under the trial program were useful. Cattle options have been the most popular with agricultural hedgers, he said. On the audit trail issue, Layton said a system to detect such abuses must exist but should not be so complicated or cumbersome that it interferes with the market or forces firms out of business.

Thomas A. Russo, of the law firm of Cadwalader, Wickersham, and Taft, stated that speculative position limits are too low, especially for financial futures; the defintion of hedging is outdated; and the concept of position aggregation should be based on actual control of positions, rather than on nominal control.

John F. Gilmore, Chairman of the Chicago Board of Trade, described the computerized trade reconstruction system, which he said will provide the time of most trade executions to the nearest minute and rapid on-line analysis of trade data. On the issue of the Commission's proposed net capital rules, Gilmore said at least 38 percent of the CBOT's member firms would be forced to come up with additional capital if the Commission's rules are adopted as proposed. Gilmore called for greater cost-benefit analysis by the Commission in its rulemaking generally, and said that the CBOT supports the Commission's proposal to require that leverage contracts be traded like other futures—on an exchange. Gilmore called on the Commission to increase market access by re-examining its definition of hedging, and by expanding options trading.

Warren W. Lebeck, representing the National Grain Trade Council, testified in support of a six-year reauthorization, and in support of requiring leverage contracts to be traded on licensed exchanges. Lebeck said agricultural options have proven their usefulness and are supported by producer groups. He called for an end to the pilot program for trading options, and urged that agricultural options, in particular, should be expanded. He said that the Council supports the Commission's proposal to eliminate the automatic stay of registered futures association disciplinary and related actions appealed to the Commission, but opposes the Commission's request for more power over association rules.

Philip A. Feigin, Chairman of the Commodities Committee, North American Securities Administrators Association, testified that NASAA strongly supports elimination of leverage contracts from separate recognition and treatment under the Act. He said that, although to do so could mean that the two firms currently trading leverage contracts would be put out of business or would have to substantially alter their form of business, the alternative would be much worse and against the public interest. To perpetuate leverage would sanction the sale of inherently unfair off-exchange futures contracts by an increasing number of leverage firms without the essential safeguards of Federal or State regulation, he noted. Feigin said NASSA supports the Commission's legislative requests in the enforcement area, and favors a six-year reauthorization.

John D. Brookmeyer, Jr., Vice President of the Prudential Company of America, testified on behalf of the Prudential Insurance Company, Metropolitan Life Insurance Company, and the Equitable Life Assurance Society of the Untied States. Brookmeyer called for a broadening of exemptions under the Commission's commodity pool operator provisions and formulation of an updated definition of hedging to recognize the concept of prudent risk management by institutional investment managers. He also took the position that requiring such persons to register with the Commission as commodity trading advisors puts them at an unjustifiable competitive disadvantage as compared to banks and trust companies, which are expressly excluded from the Commission's definition of a commodity trading advisor.

Louis E. Carabini, President of Monex International Ltd., estimated that his leverage firm does 85 percent of its business in leverage contracts, with the balance in dealer options and cash transactions. Carabini contended that leverage contracts are fundamentally and legally distinct from futures contracts, and suggested that if the Commission lacks resources to regulate leverage, the National Futures Association could do so. Carabini said Monex spent over $1.4 million in 1985 to meet the obligations imposed by the Commission's new leverage regulations. To ban leverage sales would simply ban the business of the only two companies that have satisfied strict Federal regulatory requirements, and would do nothing to prevent the spread of off-exchange fraud, he stated.

Harvey Kochen, Vice President of International Precious Metals Corporation, stated that leverage contracts are not the same as futures contracts; the new leverage regulations are effective; and responsibility for regulating the leverage business is properly placed with the Commission. If Congress removes leverage regulation from the Act, the regulated leverage transactions will become illegal, and the leverage business will be destroyed, Kochen maintained. In its place, similar instruments not subject to Federal regulation will appear to meet the public demand for alternative investment opportunities, he stated.

Steve Wilson, a commodity consultant, maintained that the commodity industry is the least regulated industry in the Western world. Current judicial and other remedies for grievances against the industry and commodity frauds are time-consuming, costly, and generally permit the fraud to continue, he said. He called for legislation to ensure that commodity customers will not be obliged by brokers to sign Consents of Jurisdiction and Arbitration until after a dispute arises.

Brooksley Born, of the law firm of Arnold & Porter, testified on behalf of the London Commodity Exchange, Limited, the Metal Market and Exchange Company, Limited, the London International Financial Futures Exchange, Limited, the Grain and Feed Trade Association, and the International Commodities Clearing House, Limited. Born said four London exchanges and their independent clearing corporations want assurance that the Commission's jurisdiction will not be extended beyond the borders of the United States. She suggested that the Commission's request for authority to serve subpenas in foreign nations would create unnecessary burdens on international commerce. Born urged clarification of section 4b of the Act to ensure that it does not apply to foreign futures traded on foreign exchanges. She contended that limiting judicial access to U.S. courts of appeal in challenges to Commission final rules or actions would unjustly limit judicial access for foreign entities that do not have a principal place of business in the United States.

John P. Doherty, Executive Vice President and Chief Executive Officer of the Illinois Cooperative Futures Company, said the Commission's current financial requirements for futures commission merchants do not accurately assess the risk of futures or options positions held by a customer in today's markets. However, he stated that the Commission's proposed concentration charge is unreasonable and would put in doubt the continued existence of the Illinois Cooperative. He proposed that financial requirements should be based on actual positions held by individual farmer-customers.

Merlyn Lokensgard, President of the Minnesota Farm Bureau, representing the American Farm Bureau Federation, said the AFBF supports the Commission's audit trail rule. An accurate trade tracking system for all trades is mandatory for the Commission to investigate allegations of manipulation, dual traders trading ahead of their customers, and other trading abuses that could threaten market integrity, he maintained.

Reggie Wyckoff, Chairman of the Marketing Committee, National Association of Wheat Growers, testified that producer concerns are adequately taken into account by the Commission. He urged the Commission to work with the exchanges in developing adequate audit trail rules.

Steven Dryer, of the law firm of Ohrenstein & Brown, recounted the details of a law suit in which he had represented a client who alleged he was victimized by dual trading in a contract market. He stated that if a more precise trade reconstruction system had been employed at the time, instead of the 30-minute time bracketing system, the question of whether unauthorized trading activities had occurred would have been easily resolved. Therefore, he supported the Commission's rule requiring exchanges to implement enhanced audit trail capabilities based on a one-minute standard.

Although unable to remain at the hearing to present oral testimony, in a submitted statement, Stephen F. Selig, Chairman of the Committee on Commodities Regulation, Bar Association of the City of New York, recommended expansion of the so-called forward contract exclusion contained in section 2(a)(1)(A) of the Act to reflect changes in off-exchange transactions among commercial firms, and financial and other institutions. Selig indicated the Bar Committee favors amendments to the Act to create a nonexclusive safe harbor to cover transactions where each party to the transaction is a commercial, financial, or institutional entity.

INTRODUCTION OF H.R. 4613

Following the Subcommittee hearings, Chairman de la Garza, along with Mr. Madigan, Ranking Minority Member of the Committee, Mr. Jones of Tennessee, Chairman of the Subcommittee on Conservation, Credit, and Rural Development, and Mr. Coleman of Missouri, Ranking Minority Member of the Subcommittee, on April 17, 1986, introduced H.R. 4613, a bill to reauthorize appropriations to carry out the Commodity Exchange Act, and to make technical improvements to that Act. The bill, as introduced, which was referred to the Committee, contained the following major provisions:

(1) Reauthorization of appropriations for the Commodity Futures Trading Commission for three years.

(2) Technical amendments to the Act to clarify that the Act prohibits fraud in connection with any futures contract, regardless of whether executed on a contract market.

(3) Express authorization for the Commission (on a majority vote of the Commission) to serve investigatory subpenas on persons outside the United States.

(4) Authority for the Commission to seek appointment of a temporary ex parte receiver when it seeks an ex parte freeze on assets or records, to prevent the assets from being dissipated or the records destroyed.

(5) Permission for Commission employees to invest in actual commodities so long as no nonpublic information is used and the transactions do not involve futures, options, or leverage; and authority for the Commission to permit other employee transactions by regulation.

(6) Simplification and clarification of Commission procedures for review of disciplinary actions brought by registered futures associations.

(7) Repeal of a provision that requires the Commission to act on registered futures association rules within 30 days.

(8) New authority for the Commission to alter futures association rules.

SUBCOMMITTEE MARKUP

The Subcommittee on Conservation, Credit, and Rural Development met on April 22, 1986, to consider H.R. 4613.

Mr. Jones of Tennessee, Subcommittee Chairman, opened Subcommittee consideration of H.R. 4613 with a brief statement. Following the opening statement of Mr. Jones, other members of the Subcommittee made statements, Committee counsel Phil Fraas gave a brief explanation of the bill, and it was opened for amendment.

Mr. Stenholm discussed the need for close coordination between the Commodity Futures Trading Commission and the Department of Agriculture. His concern related primarily to the degree of Commission involvement with the Department's implementation of the whole-herd buy out dairy program and its effect on the livestock markets. Chairman Phillips explained in general the requirements under the Commodity Exchange Act that the Commission coordinate its work with that of other agencies, including the Department of Agriculture, and described the Commission's involvement with the Department on the whole-herd buy out program. Mr. Stenholm made no motion on the issue and the Subcommittee took no action.

Mr. Weaver was then recognized to offer two amendments; but he explained that he would not offer the amendments if a satisfactory statement of the Committee's position on the issue could be agreed to. His concern involved the activities of dual traders on the floors of the exchanges. In relation to the dual trading issue, at Mr. Weaver's request, Chairman Phillips briefly described the Commission's activities in developing a better audit trail. Mr. Weaver offered a proposed statement of Committee position in lieu of his amendments, which states that the Commission should exercise its authority under the Act to determine whether the new audit trail rules would be adequate to detect dual trading abuses and whether any additional trading standards should be adopted for floor brokers or whether the practice known as "dual trading by floor brokers" should be prohibited. Following a minor change suggested by Mr. Glickman, the position statement was adopted for inclusion in the report by voice vote. The agreed-to statement, along with other such statements adopted by the Subcommittee and ratified by the Committee, are contained in the following part of this section of the report, entitled Committee Position on Certain Issues.

Mr. Glickman then offered an amendment to delete the language of the bill giving the Commission authority to modify the rules of registered futures associations. Under current law, the Commission has authority to approve or disapprove association rules but not to modify them, with limited exceptions. Mr. Glickman pointed out that general authority to modify association rules was not needed at the present time. He said no evidence was presented at the hearings that there had been any problems with respect to National Futures Association rules.

Secondly, he pointed out there has been good industry cooperation on establishing and funding the NFA self-regulatory program, and that this provision of the bill, as introduced, could jeopardize that spirit of cooperation. Further, Mr. Glickman offered a proposed statement of the Committee's position on this issue to go with the amendment that would ask the Commission to closely monitor this situation and inform the Committee if problems developed.

Chairman Phillips was then recognized and she restated the Commission's support for the request for authority to modify association rules. But she agreed with Mr. Glickman that the Commission has not experienced serious problems in its dealings with the National Futures Association. Following further debate by Mr. Stenholm, Mr. Evans of Iowa, and Mr. Coleman of Missouri, the Glickman amendment and the Committee position statement were adopted by a voice vote.

Mr. Daschle then offered an amendment to delete a provision in the bill that would authorize the Commission to serve subpenas on foreign citizens in foreign nations. Mr. Dashle argued that this provision in the bill represented an unwarranted and unneeded extension of Commission powers and would constitute a violation of international law.

Mr. Coleman argued against the Daschle amendment, pointing out a particular case (*CFTC* v. *Nahas*, described in more detail in the Purpose and Need section of this report) where the authority would have been useful. Mr. Coleman noted that some U.S. exchanges have developed or are developing trading relationships with foreign exchanges and that such international relationships justify the need for the extension of the Commission's subpena power. Mr. Coleman stated further that, if the Daschle amendment were defeated, he would offer a statement of Committee intent to clarify this provision, which would address the concerns Mr. Daschle expressed. He indicated the statement he would offer had been crafted with the cooperation of the Department of State.

Following discussion of the amendment by Mr. Glickman and Chairman Phillips, the amendment was defeated on a voice vote.

Mr. Coleman then offered his proposed statement clarifying the Committee's intent with respect to foreign subpenas. Without objection, the statement was agreed to and it appears in the Section by Section Analysis section of this report.

Mr. Glickman was then recognized to discuss two amendments he was considering offering relating to the issues of cross-margining and aggregation of positions. Following a general discussion of the two issues, Mr. Glickman and Chairman Phillips agreed to pursue both matters following the Subcommittee meeting to determine if appropriate language could be developed for presentation at the Full Commitee markup.

Mr. Stenholm then offered an amendment requiring the Commission, within 60 days after enactment of the bill, to rescind the pilot status of the current options program. He explained that the Commission's options pilot program had been operational for over three years and had demonstrated remarkable success. His amendment would expand and make permanent an already existing program for the trading of options on Commission-designated contract markets. The amendment also would delete the unnecessary requirement that the Commission provide documentation of its ability to successfully regulate options transactions. Chairman Phillips stated no objections to the proposal, but did express some reservation about the requirement to act within the 60-day period. Following discussion of the amendment by Chairman Phillips, Mr. Glickman, and Mr. Evans of Iowa, the amendment was adopted by voice vote.

Mr. Glickman then offered a proposed statement of the Committee position concerning the registration of commodity trading advisors. He explained that the purpose of the proposal is to discourage duplicative registration for entities otherwise registered under existing statutes enforced by the Securities and Exchange Commission or other Federal or State agencies, and whose futures and options trading advice is incidental to their overall securities portfolio management responsibilities. Chairman Phillips indicated that the Commission had reviewed the language and had no objection to it. The material was agreed to by voice vote.

Mr. Glickman then offered another such proposal concerning the composition of governing boards of contract markets. He explained that its purpose is to encourage exchanges to continue to have public members on boards of directors and to not take actions that directly or indirectly make their governing boards less representative. The proposed language was agree to by voice vote.

The meeting was adjourned to reconvene at 2:00 p.m., the same day.

Mr. Jones reconvened the Subcommittee for the afternoon session, and announced he was prepared to entertain proposals on the issue of leverage transactions.

Mr. Glickman was recognized to offer an amendment to require that, by January 1, 1988, all leverage contracts be traded on an exchange. The amendment also would preclude the registration of any new leverage transaction merchants by the Commission and would preclude any non-leverage firm from gaining the license of any existing registered leverage transaction merchant.

Mr. Glickman stated that he believed leverage contracts are really off-exchange futures contracts. He noted that the Commission now regulates the leverage industry, but expressed strong opposition to the anti-competitive nature of the Commission-imposed moratorium on leverage dealers and instruments. He further stated opposition to the proposition that the National Futures Association should be delegated regulatory authority over leverage transactions.

Mr. Weaver voiced opposition to the Glickman amendment and stated that he believed the public is well-protected under strong leverage regulation by the Commission and, in fact, is better protected than in the futures market.

Mr. Stenholm spoke in favor of the Glickman amendment, indicating that if it were not for the existing leverage firms in business today, he believed Congress would not allow the industry to be created today.

Mr. Evans of Iowa argued against the Glickman amendment and described the general profile of leverage customs, stating that they tend to be well-educated and sophisticated investors. He also complimented the Commission for an excellent job of established, strong customer protection regulations, and pointed out that the disclosure documents required of leverage merchants is extensive.

Mr. Coleman voiced opposition to the Glickman amendment, but noted that he was continuing to work with interested parties to achieve a compromise on this issue.

Mr. Jones noted that the leverage industry has made a substantial financial commitment to comply with regulations issued by the Commission, and that this investment will be wasted if the Glickman amendmnt is adopted. He also stated that the existing leverage firms are providing legitimate investment opportunities to the public and, furthermore, offer needed competition that would be stifled by the Glickman amendment.

Mr. Daschle argued in support of the Glickman amendment, stating that he believed leverage contracts and futures contracts are indistinguishable.

Mr. Jeffords stated his opposition to the Glickman amendment, but indicated he was working to develop a better solution to the issue.

At the conclusion of debate, a vote on the Glickman amendment was called. Mr. Glickman requested a show of hands and, on a division vote, the amendment was defeated by a vote of five yeas and nine nays.

Mr. Glickman offered a proposed statement of the Committee's position concerning the definition of hedging, and after discussion and questioning by the Subcommittee members, withdrew the language.

Mr. Evans of Illinois offered a statement of the Committee's position regarding the proposed Commission audit trail regulations. Mr. Evans pointed out that the Commission and industry representatives had reviewed his proposal and found it helpful. Following a brief discussion, it was adopted by voice vote.

Mr. Jones inquired if there were further amendments or discussion. There being no repsonse, Mr. Glickman then moved that H.R.

4613, as amended, be reported to the Full Committee with a recommendation that it do pass.

By a voice vote, the motion was agreed to in the presence of a quorum. Under unanimous consent request by Mr. Glickman, the staff was given permission to make any necessary clerical and technical changes.

COMMITTEE MARKUP

On May 7, 1986, Chairman de la Garza convened the Full Committee in an open business meeting called to consider H.R. 4613, as reported by the Subcommittee on Conservation, Credit, and Rural Development on April 22, 1986. Following a brief statement by Mr. Jones of Tennessee, Subcommittee Chairman, Committee Counsel Phil Fraas was recognized for a brief explanation of the bill. Then followed a general discussion of the leverage industry and leverage trading, involving Mr. Smith, Mr. Panetta, Mr. English, Chairman Phillips, and others. Mr. English inserted in the record a paper comparing futures contracts and leverage contracts.

Mr. Glickman then offered an amendment that he described as an amendment to eliminate leverage. The amendment would require that, by January 1, 1988, all leverge contracts be traded on Commission-regulated exchanges; and it would preclude any new firms entering into the leverage transaction business and would preclude any non-leverage firm from gaining the license of a registered leverage transaction merchant. Chairman de la Garza stated it was his intention that the three major leverage amendments, Mr. Glickman's, Mr. English's, and Mr. Jeffords's, would be taken in order and dealt with individually.

An extended debate ensued involving several members of the Committee and Chairman Phillips. The debate involved leverage transactions—whether they should be allowed to continue; whether they should be required to be traded on exchanges; whether the moratorium should be lifted so that the leverage industry could expand; and various regulatory approaches.

Mr. Glickman generally argued that leverage transactions are essentially off-exchange futures contracts and should be traded on exchanges. Mr. English, Mr. Daschle, and Mr. Gunderson supported this view.

Mr. Jeffords, Mr. Coleman, Mr. Weaver, Mr. Evans, and Mr. Jones of Tennessee argued that leverage trading is a distinct form of commercial activity, different from futures trading. Further they pointed out that the requirement to regulate leverage trading has been a part of the Act since the Commission was created in 1974, and that currently leverage trading by the two registered firms takes place under a set of Federal regulations that are as strong, if not stronger, than futures regulations. Mr. Evans said that the basic issue is the fear of competition on the part of the exchanges and that leverage served a distinct and good economic purpose for leverage customers who tend to be sophisticated investors.

Following the debate, the Glickman amendment was defeated by a voice vote. Mr. Glickman then requested a recorded vote on the amendment and a sufficient number of members supported the request. By a roll call vote of 12 yeas and 30 nays, the Glickman amendment was not agreed to.

Mr. Jeffords offered an amendment concerning leverage transactions that would limit leverage transactions to precious metals, and require the Commission to conduct a survey of additional firms that may be interested in entering into the leverage business and report to Congress the survey results. The report would include proposed new regulations to govern leverage trading, and the Commission would be required to permit the entry of additional firms into the business but could provide for gradual entry of new firms. Additionally, the amendment would authorize the Commission to delegate to an approved industry association appropriate self-regulatory functions over leverage transaction merchants and leverage trading.

Mr. Madigan then offered an amendment to the Jeffords amendment to require that the report submitted to Congress by the Commission contain the Commission's recommendations concerning whether leverage transactions serve an economic purpose. The Madigan amendment to the Jeffords amendment was agreed to by a voice vote.

Committee discussion continued on the pending Jeffords amendment. Mr. Jeffords received permission that he, the Committee staff, and representatives of the Commission be permitted to make clarifying and perfecting changes in the draft amendment during the noon recess, to be considered by the Committee in the afternoon session. The Chairman then recessed the morning session.

Chairman de la Garza called the Committee to order for the afternoon session and Mr. Jeffords distributed a revised amendment concerning leverage transactions. After discussion of the revised language, the modification of the amendment was agreed to without objection.

Mr. English then offered a two-part amendment to the Jeffords proposal concerning leverage trading regulation. After discussion by the Committee, Mr. English asked unanimous consent that the two sections of his amendment be considered separately, and there was no objection.

Section 1 would strike out the provision of section 2(a)(1) of the Commodity Exchange Act that gives the Commission exclusive jurisdiction over leverage transactions. By a voice vote, section 1 was not approved.

Section 2 would provide leverage regulatory authority to States and other Federal agencies. By a voice vote, section 2 of the English amendment was approved for incorporation into the Jeffords proposal. The amendment was later withdrawn, as described below.

Following approval of section 2 of the English amendment, it was noted that counsel for the Commission was concerned about the language of the amendment in light of the Committee's discussion of its meaning. Chairman de la Garza instructed Committee counsel and Commission counsel to work with Mr. English and Mr. Madigan to clarify the language of the amendment to ensure that it reflected the Committee's intent and that the revised language would be brought back to the Committee for approval, if necessary.

Mr. Gunderson then offered an amendment to the Jeffords proposal that would open up leverage to include all commodities after the two-year Commission study is completed and after appropriate regulations are promulgated. After considerable debate concerning the future of the leverage industry and the Commission's ability and resources to regulate and expand the industry, the Gunderson amendment was defeated by a voice vote.

Mr. Glickman then offered an amendment to the Jeffords proposal that would expand the commodities on which leverage contracts could be offered to include foreign currencies and copper, in addition to gold, silver, and platinum. Mr. Glickman pointed out that leverage contracts currently are mandated on foreign currencies and copper, and he questioned why these two types of commodities were eliminated in the Jeffords amendment. Mr. Jeffords pointed out that all but five or six percent of current leverage activity is in the precious metals. Mr. Jeffords further said that his proposal was not intended to discriminate against any particular futures exchange, but that in his judgment, leverage should be limited to gold, silver, and platinum, particularly since there remained a potential of an expanded number of firms in the industry within two years. On a division vote of nine yeas and twelve nays, the Glickman amendment was defeated.

Mr. English then offered an amendment to the Jeffords proposal that would require the Commission to take steps to prohibit price manipulation on or off exchanges. Chairman Phillips pointed out that she did not feel current law limits the ability of the Commission to investigate price manipulation either on exchanges or in the leverage industry. Mr. Glickman pointed out that there are already existing Federal statutes that deal with the issue of price manipulation and expressed his concern that adoption of the English amendment might be duplicative or even a weakening of existing statutes. Mr. English then withdrew the amendment.

Mr. Volkmer then offered an amendment to the Jeffords proposal which would change from 30 calendar days to 45 calendar days the period during which either House of Congress must be in session before leverage regulations submitted to Congress under the amendment will become effective. The Volkmer amendment was adopted without objection.

The Chairman then called the question on the Jeffords amendment, as amended. It was agreed to by a voice vote.

Mr. Stenholm was recognized to offer a technical amendment to an amendment that previously had been adopted by the Subcommittee to make permanent the options trading program. He explained that his technical amendment would change from 60 days to 90 days after enactment of the bill the amount of time the Commission would have to make the program permanent. The Stenholm technical amendment was agreed to without objection.

Mr. Glickman offered three items stating the Committee position on futures regulatory issues: first, on behalf of himself and Mr. Stenholm, language concerning the aggregation of accounts controlled by the same party for purposes of the application of position limits; second, on behalf of himself and Mr. Jones of Tennessee, language concerning speculative position limits; and, third, on behalf of himself and Mr. Jones of Tennessee, language concerning the Commission's definition of hedging. Following a brief discussion, without objection the Committee agreed to the proposals. The statements, along with other such statements approved by the Committee, appear in the following part of this section of the report, entitled Committee Position on Certain Issues.

Mr. English then offered statements to clarify the intent of sections of the bill dealing with fraudulent practices and extraterritorial service of subpenas by the Commission. Additionally, Mr. English proposed to have incorporated into the report a letter from Chairman Phillips to Subcommittee Chairman Jones dated May 1, 1986, regarding extraterritorial subpenas. Without objection, the Committee agreed to the English proposals, which appear in the Section by Section Analysis and Administration Views sections of this report.

Mr. Stenholm then offered a statement of the Committee's position concerning liaison between the Department of Agriculture and the Commission. The proposal related to discussions held previously in the Subcommittee between Mr. Stenholm, Chairman Phillips, and other members of the Committee. Without objection, the Committee agreed to the Stenholm proposal.

Chairman de la Garza then moved that the Committee ratify statements of the Committee position and intent that had been accepted by the Subcommittee and submitted to the Committee. Without objection, the Committee agreed to the material, except for those parts relating fraud jurisdiction under section 4b of the Act and extraterritorial service of subpenas, which are superseded by the English proposal previously approved by the Committee.

Mr. Emerson offered a statement of Committee position that calls on the Commission to conduct a cost-benefit analysis as a part of its rulemaking procedure. After accepting clarifying language offered by Mr. Bedell, the Emerson language was approved without objection.

Mr. Jones of Tennessee then moved that H.R. 4631, as amended, be reported to the House with recommendation that it do pass. The motion was agreed to by a voice vote and in the presence of a quorum of 27 present and voting. The bill was ordered reported subject to final disposition of the English leverage regulatory amendment. Under unanimous consent, the staff was given permission to make any necessary clerical and technical changes in the bill and the report.

On May 21, 1986, Chairman de la Garza called to order a meeting of the Full Committee to clarify the Committee's intent when it accepted an amendment involving regulatory jurisdiction over leverage trading offered by Mr. English on May 7. Following a discussion of the issue, Mr. English withdrew his amendment.

COMMITTEE POSITION ON CREATION ISSUES

CFTC oversight of NFA rulemaking

During the hearings of the Subcommittee on Conservation, Credit, and Rural Development on reauthorization of appropriations for the Commodity Futures Trading Commission, several witnesses addressed the performance of the futures industry's self-regulatory body, the National Futures Association, during the previous four years. In addition, the Committee has received several periodic reports about the NFA, including the Commission's essentially favorable evaluation of NFA in the report called for under the Futures Trading Act of 1982. In this regard, the Committee believes that the relationship between the NFA and the Commission has worked satisfactorily.

The Committee bill retains existing law on the issue of the Commission's power to alter or supplement rules developed by NFA. An amendment proposed by Mr. Glickman and adopted by the Subcommittee in its markup of the bill struck out the Commission's proposal to grant the Commission additional power to alter registered futures association rules.

Notwithstanding the Committee's view that this power is not needed at this time and notwithstanding the adoption of the amendment to strike out the Commission proposal, the Committee will continue to follow very closely the development of NFA to ensure that it fulfills its obligations as a self-regulatory organization under Commission oversight. If NFA continues to meet those obligations, the Committee expects that it will continue its current view of the adequacy of the Commission's oversight powers.

Audit trail

On January 14, 1986, the Commission adopted a new regulation designed to achieve more effective audit trails on the commodities exchanges. Through the reconstruction of trading activity, audit trails provide an important exchange surveillance tool. Thus, audit trails facilitate the exchanges' ability to detect and punish persons engaged in improper and unethical practices.

The Commission's new regulation provides that the time of execution for each futures and options transaction be identified, by means developed by the exchange, to the nearest minute. In addition, the Commission's regulation calls on the exchanges to demonstrate the capability to use effectively this trade timing data in their self-regulatory programs.

In preparation for the Subcommittee hearings on reauthorization, Committee staff received a demonstration of a new audit trail system devised jointly by the Chicago Board of Trade and the Chicago Mercantile Exchange, called the Computerized Trade Reconstruction System. The Chicago exchanges developed this system to satisfy what they understood to be the requirements of the Commission's audit trail rule. The exchanges recognize that the CTR system will not capture accurately the trade times of every futures or options tranaction. Indeed, in fast-paced, liquid futures and options trading, where simultaneous multiple executions frequently occur, it would be impossible to determine accurately the exact sequence of every transaction. Nevertheless, the exchanges believe the CTR system will accomplish the Commission's objective of an effective audit trail.

Based on that premise, the exchanges presented their CTR system to the Commission and provided each Commissioner with a personal demonstration of the CTR system's expected capabilities. The exchanges also have described the CTR system to the Commission in writing. As explanied to the Committee in testimony during the hearings on reauthorization, the exchanges provided these demonstrations and materials to the Commission in order to receive sufficient assurances from the Commission that the CTR system would satisfy the new audit trail regulation before the exchanges expended the substantial resources required to implement fully the CTR system.

At the hearings, Committee members thoroughly questioned Commission Chairman Phillips on the Commission's intentions with regard to the audit trail regulation and the CTR system. Chairman Phillips testified that the one-minute timing standard of the new regulation was intended to be a goal toward which the exchanges should strive and that it should not be interpreted or applied in its narrowest or most technical sense.

Chairman Phillips explained that the Commission's purpose in adopting the audit trail regulation was to create an effective audit trail. Chairman Phillips further stated that, based on the exchanges' representations, the Commission anticipates that the CTR system would be capable of complying with the Commission's audit trail regulation when the system is operational. Finally, Chairman Phillips testified that the exchanges would not be liable if they failed to capture the trade time of every trade executed on the floor of their exchanges. Indeed, Chairman Phillips testified that the Commission would be satisfied if the exchanges could capture 90 percent of the trade times, recognizing that in fast-paced markets the threshold compliance level could be reduced to reflect market reality.

Based on these representations from the exchanges and the Commission, the Committee understands that the exchanges now plan to proceed in good faith to implement their CTR system. The Committee applauds the exchanges' decision. The Committee anticipates that the Commission will administer its new audit trail regulation in a manner designed to accomplish the ultimate goal of an effective audit trail, and will not interpret the new regulation's one-minute timing requirement in its narrowest, most technical sense, consistent with the Commission's testimony before the Committee.

The Committee anticipates that the Commission and the exchanges will keep the Committee fully apprised of developments concerning the audit trail rule and the CTR system. The Committee is well aware that the audit trail issue has been a major controversy since the creation of the Commission. The Committee is pleased that the Commission has moved forward on this issue, and expects the efforts in this area to produce even stronger public protections that exist today.

Dual trading

The practice known as dual trading permits a floor broker to trade for his own account, or any account in which he has trading discretion, and also execute a customer's order for commodity futures contracts. Section 4j(1) of the Act required the Commission to make a determination, within nine months after the effective date of the Commodity Futures Trading Act of 1974, whether or not dual trading by floor brokers should be permitted. Section 4j(1) also empowers the Commission subsequently to determine that changes may be required with respect to its original determination.

After studying the issue, the Commission determined not to prohibit dual trading per se, but did adopt, in 1977, trading standards for floor brokers. The standards generally require exchanges to have rules requiring their member floor brokers to execute customer orders before executing the brokers' own orders. The Commission subsequently adopted rules under section 4c of the Act to extend these standards to the trading of commodity options.

The Committee is aware that the Commission recently has adopted new audit trail regulations to enhance its ability to reconstruct futures and options trading on the exchanges. These rules are designed to enable the exchanges and the Commission, among other things, more easily to detect violations of floor broker trading standards.

Nevertheless, the Committee is concerned that, even with the new audit trail requirements, there may be dual trading abuses occurring on the floors of the exchanges in violation of Commission rules. Therefore, the Committee believes that, on implementation by the exchanges of audit trail rules, the Commission should exercise its authority under the Act to determine whether the audit trail rules are adequate to detect such possible abuses, and whether any addition trading standards should be adopoted for floor brokers or whether the practice known as dual trading by floor brokers should be prohibited.

Liaison between the Department of Agriculture and the Commission

Section 2(a)(8)(A) of the Act provides for a cooperative liaison relationship between the Department of Agriculture and the Commission. One purpose of this statutory requirement is to ensure that critical information developed by these two agencies can be shared. Frequently, the Department of Agriculture has new information about supply and demand conditions or changes to price support or marketing programs that could have a significant effect on futures markets as well as cash markets for agricultural commodities. Similarly the Commission may have information about futures market operations, large trader activity, or futures contract specifications that may be significant for programs of the Department of Agriculture. An active liaison relationship between these two agencies is necessary to enable both to accomplish their mission effectively and in a manner that will be beneficial to this Nation's agricultural economy.

The Committee understands that there has been a continuing liaison between the Department of Agriculture and the Commission during the Commission's twelve-year history. This liaison has functioned at several levels—between the Chairman or designated liaison of the Commission and the Secretary's designee, and on the staff level on an as-needed basis. A Department of Agriculture representative occasionally attends Commission market surveillance briefings, depending on the contracts being discussed.

The Commission urges both the Department of Agriculture and the Commission to maintain an active liaison on issues of mutual importance and review the procedures by which information is shared between agencies. For exmaple, the Department Agriculture should consider the timing of the public release of sensitive information to allow sufficient time for futures and cash market participants to assess the new information. Similarly, the Commission, in recognition that agricultural futures and option markets are inextricably tied to the cash markets for those commodities, should provide the Department of Agriculture, on request, with pertinent information and consultation regarding futures market conditions or potential market conditions in a timely fashion.

Cost-benefit analysis

In the past four years, the Commission has undertaken a number of ambitious and far-reaching rulemakings. Futures exchanges, as well ss other industry participants, complained that the Commission's rulemakings were not sufficiently focused to permit intelligent and meaningful public comment. In particular, the exchanges pointed out that many of these rulemaking were begun by the Commission without first considering whether the rulemaking proposals involved costs to the public that outweighed any possible benefit.

The Committee does not want to inhibit the Commission's ability to implement provisions of the Act through appropriate rulemaking proceedings. For this reason, the Committee, in its action on this legislation, did not adopt any specific statutory language directing the Commission to perform comprehensive cost-benefit analyses on proposed rulemaking. Nonetheless, the Committee fully appreciates that no Commission rule should be adopted if its cost outweigh the benefits to the public and other parties who rely on the Commission's regulatory scheme. The Committee therefore believes that the Commission should consider, whenever the Commission determines it appropriate, the cost-benefit implications of proposed and final rules in order to promote more effective and efficient Commission rulemaking.

Aggregation of accounts

During the subcommittee hearings on reauthorization, several witnesses expressed dissatisfaction with the manner in which certain market positions are aggregated for purpose of determining compliance with speculative limits fixed under section 4a of the Act. The witnesses suggested that, in some instances, aggregation of positions based on ownership without actual control unnecessarily restricts a trader's use of the futures and options markets. In this connection, concern was expressed about the application of speculative limits to the market positions of certain commodity pools and pension funds using multiple trading managers who trade independently of each other.

The Committee does not take a position on the merits of the claims of the witnesses. Nor does the Committee agree with the view that the Commission lacks sufficient flexibility under the existing law to grant exemptions from any limits set under section 4a. The Committee believes that the Commission is not prohibited from granting exemptions from the literal application of the speculative limits set under the provisions of section 4a so long as such exemptions are not contrary to the stated purposes of those provisions. In this regard, the Committee recognizes the Commission's concern about the effect that any such exemptions may have on speculative activity, particularly in the agricultural markets. The Committee is aware of the Commission's policy of obtaining the advice of its appropriate advisory committees in this case the Agricultural Advisory Committee and its Fanancial Products Advisory Committee. The Committee endorses this policy and urges the Commission to examine this issue.

Speculative position limits

During the subcommittee hearings on reauthorization, a number of witnesses, including market users and the exchanges, discussed the need for the Commission to reexamine the current levels of speculative position limits. In summary, they indicated that the current levels, both those set by the Commission in certain agricultural futures contracts, such as wheat, corn, soybeans, and cotton, and others set by the exchanges subject to Commission approval, are in many cases low in relation to the current size, liquidity, and hedging use of market effects. In addition, some witnesses stated these limits may impede the growth and development of these markets without any commensurate regulatory benefits.

The Committee understands that, in developing and implementing policies on speculative position limits, the Commission is properly mindful of the potential effects on the integrity of the futures and options markets and related cash markets. However, consistent with the foregoing, the Committee believes that, given the changes in the nature of these markets and the influx of new market participants over the last decade, the Commission should reexamine the current levels of speculative position limits with a view toward elimination of unnecessary impediments to expanded market use.

In particular, speculative positions in the agricultural futures contracts subject to Commission-set limits, which in many cases have remained unchanged for years, need to be reviewed. For contracts subject to exchange-set limits, the Committee believes that the Commission should give prompt consideration to reasonable requests by the exchanges to raise their limits under Commission Rule 1.61. Since speculative limits are intended to serve as a check against potentially manipulative market forces, it is also important that these limits be periodically reassessed to determine their relationship to supply and demand factors in underlying markets as well as their compliance with other Rule 1.61 standards.

The Committee has noted a decline in futures trading volume in deferred months. The results of this decline is that producers find it more difficult to rely on the futures markets both for hedging opportunities and for meaningful price discovery in deferred months. The Committee also has been advised that the success of the agricultural commodities options program to date could be further enhanced by providing for appropriately increased speculative limits.

The Committee particularly encourages the Commission to consider restructuring its speculative limits and to consider exchange requests to restructure their speculative limits to permit greater flexibility in the application of such limits to individual delivery months and all delivery months combined. The Committee specifically notes that section 4a(1) of the Act expressly permits the Commission to fix positions on a per future or per delivery month basis. Thus, existing law authorizes the Commission to set or approve an independent speculative limit for each delivery month traded. Under this approach, a trader could maintain, for example, positions in each of the May 1986 future, the July 1986 future, and the May 1987 future at existing speculative limit levels. However, the Committee also recognizes that the Commission's decision to implement such an approach would depend on the circumstances pertaining to a particular market.

Such an approach need not result in any increase in position limits in spot months. The Committee believes that this approach may promote greater hedging opportunities in all delivery months while fostering better price discovery and stability for producers and other market users. Accordingly, the Committee urges the Commission to give prompt attention to increasing and restructuring the Commission-set speculative limits, and to similar proposals for exchange-set speculative limits consistent with the foregoing discussion.

Hedging definition

Section 4a(3) of the Act authorizes the Commission to define the term "bona fide hedging transaction" for the purpose of exempting such transactions from any position limits that are imposed on speculative futures trading. Under this authority, the Commission, in 1977, adopted a hedging definition that includes both a specific, itemized list of hedging transactions, as well as a general, conceptual definition of hedging. The Commission's hedging definition also serves, in part, as a basis of identifying those institutional investors that need not register as commodity pool operators.

During the subcommittee reauthorization hearings, a number of futures industry representatives testified that the current hedging definition, which has not been modified in almost ten years, needs to be revised and updated. The witnesses recommended that this revision should be done by the Commission and should focus on the new financial futures and options markets. The principal problem they identified in the current definition is its focus on agricultural and other physical commodity futures.

These witnesses stated that, depending on how the definition is interpreted, it may not recognize certain new uses of financial futures and options by investment advisers, banks, and insurance companies that manage pension funds, mutual funds, and other portfolios who must choose among different investments with varying levels of risk and anticipated returns.

The Committee concurs in the view that the Act already provides the Commission with the power to make any needed revisions in the hedging definition and that no statutory changes are required at this time. The only limit section 4a(3) places on the Commission's power to define hedging is that the definition must be consistent with the purposes of the Act. In this context, a principal purpose of the Act, as set forth in section 4a(1), is to prevent excessive speculation which might cause sudden or unreasonable fluctuations or unwarranted changes in commodity prices. At the same time, section 3 of the Act has reflected congressional interest for over sixty years in facilitating hedging transactions. Within these broad parameters, the Commission clearly has the necessary power, as well as the responsibility, to define hedging in a way that is consistent with the current needs and practices of the industry. Indeed, this Committee asked the Commission in 1974 to "define hedging in a manner more consistent with the times and practices of the industry. It is not the intent of the Committee that it be used to overly restrict industry use of the features markets for hedging." See House Report 93-975, 93d Congress, 2d Sess., 31-32 (1974).

The Committee strongly urges the Commission to undertake a review of its hedging definition for the purpose of ensuring that the definition is, in fact, current with the legitimate needs and practices of the industry. As part of this review, the Committee wishes the Commission to consider giving certain concepts, uses, and strategies "non-speculative" treatment under the Act and relevant Commission regulations, whether under the hedging definition or, if appropriate, as a separate category similar to the treatment given certain spread, straddle, or arbitrage positions: one, the concept of "risk management" by portfolio managers as an alternative to the concept of "risk reduction"; two, futures positions taken as alternatives rather than temporary substitutes for cash market positions; three, other trading strategies involving the use of financial futures including, but not limited to, asset allocation (altering portfolio exposure in certain areas such as equity and debt), portfolio immunization (curing mismatches between the duration and sensitivity of a pension fund's assets and liabilities to ensure that portfolio assets will be sufficient to fund payment of its liabilities) and duration (altering the average maturity of a portfolio's assets); and four, options transactions, in particular the writing of covered puts and calls.

In light of the above, the Committee suggests that the Commission review whether a numerical completion test for determining whether a transaction qualifies as an anticipatory hedge is appropriate for financial futures and options contracts. The Commission's focus could be on the intent and purpose of a transaction interpreted in the context of an entity's overall investment objectives and the purposes of the Act, without unnecessary resort to a numerical test which may frustrate legitimate use of these markets.

In conducting these reviews, the Commission should be mindful of the larger role that its pronouncements may play in identifying the economic functions of the futures and options markets. The Commission's hedging definition may serve as one source of guidance concerning the legitimate uses of these markets for both current and potential market users, as well as for other regulatory agencies, Congress, and the general public. In exercising its powers, the Commission, therefore, should recognize its role in this area and endeavor to balance its responsibilities for orderly markets with the objective of appropriate commercial and investment use of the options and futures markets.

Commodity trading advisors

Representatives of the life insurance industry have proposed that the definition of "commodity trading advisor" in the Act be amended to exclude any investment adviser registered with the Securities and Exchange Commission under the Investment Advisers Act of 1940 whose advice concerning commodity interests is solely in connection with the management of institutional securities portfolio. The life insurance industry urged that such an exclusion is necessary to avoid duplicative and inappropriate regulation, and to put institutional investment advisers such as insurance companies on a par with banks and trust companies, which are already excluded from the definition of commodity trading advisor if their commodity advisory activities are solely incidental to the conduct of their business as banks and trust companies. Other witnesses supported the insurance companies' proposal.

The Commission opposed the proposed statutory exclusion as too broad. The Commission further indicated that it did not consider the proposed statutory amendment necessary in any event, since the Commission has existing authority under section 2(a) (1) (A) of the Act to not include within the definition of a commodity trading advisor "such other persons not within the intent of this definition as the Commission may specify by rule, regulation, or order." In this connection, the Commission advised the Committee that within the past year its staff received and affirmatively responded to two "no-action" requests from an insurance company regarding some of the problems that would be addressed by the proposed amendment. The Commission further advised the Committee that it is prepared, and has ample authority, to address the concerns of the life insurance industry as that industry becomes more active in the commodity markets.

The Committee believes that any insurance company subject to regulation by State insurance departments (including any wholly owned subsidiary or employee thereof), provided its commodity advisory activities are solely incidental to the conduct of the business of the insurance company as such, generally is not within the intent of the definition of the term "commodity trading advisory." The Committee similarly believes that any person who is excluded from the definition of the term "commodity pool operator" by Commission Rule 4.5 should be excluded from the commodity trading advisor definition, provided its commodity advisory activities are solely incidental to its operation of those trading vehicles for which Rule 4.5 provides relief. Relatedly, where the advisor advises an entity that is excluded from registration as a commodity pool under Rule 4.5 or is a Rule 4.5 qualifying entity and such advisor is subject to appropriate regulation under the Investment Advisers Act, that advisor should ordinarily be exempted from commodity trading advisor registration if its commodity advice is solely incidental to its business of providing securities advice to such entity and the advisor is not otherwise holding itself out as a commodity trading advisor. Therefore, the Committee urges the Commission to exercise its authority to adopt regulations in regard to these matters.

Should the Commission determine that registration as a commodity trading advisor is required, the Committee expects that the Commission will use its existing authority to consider other appropriate relief. In this regard, the Committee is aware that the Commission has exercised its authority to limit, by exemption, those employees of otherwise regulated entities who must register as an associated person of a commodity trading advisor. The Committee further understands that the Commission has coordinated its activities with the Securities and Exchange Commission to eliminate duplicative requirements, for example, by deeming in appropriate cases compliance with SEC disclosure, recordkeeping, and reporting requirements as sufficient compliance with the Commission's corresponding commodity pool operator requirements. The Committee intends that the Commission will continue to provide this and such other relief as may be appropriate to applicants for registration as a commodity trading advisor or in any other registration category.

On the other hand, the Committee does not expect the Commission to grant exempted commodity trading advisors any relief from the antifraud provisions of section 4*o* of the Act.

The Committee understands that rulemaking addressing these concerns may take some time for the Commission to develop and promulgate. Individual requests for exclusions or exemptions, consistent with the above guidelines, however, should be processed by the Commission as expeditiously as practicable. The Commission's experience with individual cases should facilitate the formulation of more general rulemaking.

Composition of the governing boards of contract markets

During the subcommittee hearings on reauthorization, witnesses testified that the several categories of futures market participants—including brokerage houses, commercial users such as farmers and other hedgers, floor traders, and the general public—currently are more fully represented on the boards of the commodities exchanges than they have been in the past. For example, three exchanges—the Chicago Board of Trade, the Chicago Mercantile Exchange, and the Kansas City Board of Trade—have added representatives of the agricultural community to their governing boards since the reauthorization of appropriations for the Commission in 1982, complementing steps other exchanges have taken to include public members on their boards. In addition, the futures industry's self-regulatory body, the National Futures Association, has attempted to make its governing board representative of all entities it is responsible for regulating.

Because the commodities exchanges are quasi-governmental bodies providing the sole mechanism through which futures contracts can be publicly traded in the United States, the Committee believes the movement in the commodities industry to broader representation, including representation for farmers and other users, is laudable. The Committee strongly believes the pendulum should not be allowed to swing in the other direction. Entities that enjoy an exclusive statutory franchise and have the authority to establish rules—limiting access to their markets, prescribing trading practices, and disciplining errant members—possess a public trust of sorts. They should not take actions that directly or indirectly make their governing boards less representative of the exchange community. Indeed, the Committee notes its view is shared by other entities concerned with the financial community: The National Association of Securities Dealers, Inc., like the National Futures Association, has attempted to make its board broadly representative of securities market users. Also, when a major securities options exchange recently proposed to amend its rules to give greater control to a particular segment of market users, the Securities and Exchange Commission refused to approve the rule change.

In light of the significance of this matter, the Committee believes the Commission should monitor the composition of the boards of the commodities exchanges and encourage the exchanges to have broad representation on their boards to include the various categories of market participants and the various parties with an interest in the markets.

PROGRAM TRADING

The Committee has become increasingly concerned about the effects of program trading in stock index futures and options and the underlying stocks. Serious questions have been raised regarding the effect of certain trading activities in these markets. Of particular interest is the extent to which these activities contribute to the volatility of the stock market, especially on those occasions when contracts on stock options, stock index futures, and stock index options all expire on the same day.

In a continuing effort to monitor this situation, Representatives Jones of Tennessee and Coleman of Missouri, Chairman and Ranking Minority Member of the Subcommittee on Conservation, Credit, and Rural Development, initiated the following correspondence with Chairman Susan M. Phillips of the Commodity Futures Trading Commission:

U.S. House of Representatives
Committee on Agriculture,
Subcommittee on Conservation, Credit, and Rural Development,
Washington, DC, April 15, 1986.

Hon. Susan M. Phillips,
Chairman, Commodity Futures Trading Commission,
Washington, DC

Dear Madam Chairman: In your March 18 testimony before this Subcommittee and in a February 4, 1986, letter reporting on the status of various Commission activities, you provided a useful review of the activities that were being undertaken by the Commission in cooperation with the SEC to address the so-called "third Friday phenomenon" associated with trading in stock index futures and options. In view of the continued stock market volatility that has been attributed to program trading and the recently completed study by Professor Hans Stoll that was undertaken under the auspices of several securities exchanges, the Subcommittee would appreciate a more detailed and updated review of the Commission's activities in this area.

In particular, we are interested in the Commission's specific thoughts on the Stoll study with reference to its conclusions and recommendations. We are also interested in the Commission's surveillance experience in recent stock index futures expirations and whether the Commission plans any formal studies of its own on this issue or other issues related to stock market volatility, stock index futures and options trading. Finally, please provide information on any further contact that the Commission has had with the SEC or self-regulatory organizations on this issue.

We appreciate any assistance that the Commission can lend the Subcommittee on this issue.

Sincerely,

ED JONES,
Chairman.
E. THOMAS COLEMAN,
Ranking Minority Member.

COMMODITY FUTURES TRADING COMMISSION,
Washington, DC, April 18, 1986.

Hon. ED JONES,
Chairman, Subcommittee on Conservation, Credit and Rural Development, U.S. House of Representatives, Washington, DC.

DEAR MR. CHAIRMAN: I am pleased to respond to your letter of April 15, 1986, concerning the Commission's most recent activities in connection with the cash market effects of certain stock index futures and option trading strategies.

With regard to your question on the recently completed study of the expiration day effects by Professor Hans Stoll, Commission staff is curently reviewing carefully the report's technical analysis. The Commission nevertheless offers some preliminary thoughts on the study.

The Commission believes that Professor Stoll's findings of statistically significant effects from the completion of stock index arbitrage programs on stock market volume and stock price volatility are generally valid and consistent with the Commission's surveillance experience on this issue. In this regard, however, because of the time constraint under which it was undertaken, the study, which focused on expiration day effects, does not explore fully certain issues which the Commission believes deserve further analysis. For example, because of the deadline for the study, Professor Stoll was unable to review the latest expiration day observation, March 21, 1986, on which occurred the largest stock market price movement associated with any futures or option expiration to date. This not only would have increased the statistical effect identified in the study but also brings into question some of the qualified statements made in the study regarding the diminution of the effect over time. More generally, the focus of Professor Stoll's study is the expiration day effects of stock index futures and option trading and hence the study does not address the potentially broader effects of futures and option related program trading on days other than expiration Fridays. The Commission believes that this latter area also must be addressed before a regulatory approach to these effects can be assessed.

The study's assessment of the *economic* significance of the expiration day effects of stock index futures and option trading appropriately suggests that such effects should be viewed in the broader context of the overall benefits that index derivative instruments can provide. However, some of the comparisons of the magnitude of the effects may require further study, e.g., the study's comparison of block trading effects in individual stocks versus the expiration effect in a 500-stock average. Other effects also may require investigation, such as the triggering of stop-loss orders in individual stocks which may be significantly affected by expiration or other futures or option trading-related price changes.

As was indicated in the study, the predictability of stock market price moves at the close of trading on expiration days may be greater for some market participants with knowledge of potential or actual order flows. Nevertheless, Professor Stoll makes a good point that there is no clearcut way to know routinely if there will be an effect and what its direction will be. The issue of predictability is further complicated by consideration of program trading effects on non-expiration days, which, as noted, were not examined in Professor Stoll's study.

In a summary discussion accompanying his study, Professor Stoll briefly evaluates five alternative proposals for changes in procedures designed to deal with expiration effects. These five alternatives are: telescoping of position limits, requiring delivery stocks or evidence of stock ownership in place of cash settlement, using an average of index values for cash settlement, disclosures and modifications of stock market procedures, and shifting expiration days away from a common date. We believe this preliminary discussion contributes an important initial review of alternative approaches. These alternatives will receive more concentrated review in subsequent consideration of policy alternatives by the CFTC in its general oversight activities and in coordination with the Securities and Exchange Commission.

The sharp decline in the stock market which occurred near the close of trading on the March 21, 1986, futures and options expiration date currently is under review by both the securities and commodities regulatory bodies charged with oversight responsibilities. An analysis of the events of March 21 is being undertaken by the Intermarket Surveillance Group (ISG), which consists of securities self-regulatory organizations and includes commodities self-regulatory organizations in the review of such expiration day effects. In particular, detailed information regarding the stock market and stock index futures and option market activities of fifteen firms identified as active stock traders near the close on that day is being gathered by the ISG. The ISG is also contemplating a detailed review of market activity on days other than expiration Fridays on which stock index futures and option program trading is thought to have affected stock market prices significantly.

Pending the outcome of these specific studies, the Commission continues to monitor closely stock index futures trading through its daily surveillance program, with particular regard to potential effects of arbitrage strategies on the pricing efficiency of the futures and related markets. This review is proceeding in close cooperation with the SEC and involves commodities and securities self-regulatory organizations. Chairman John Shad of the SEC and I have discussed this issue, most recently this week. I believe we share similar concerns about such trading as well as an appreciation of the economic benefits of stock index option and futures markets. The SEC is exploring with the stock exchanges possible operational procedures which might alleviate the expiration effects of derivative instruments. Also, I note that Commission as well as SEC staff have been attending meetings of the Derivative Products Committee of the Securities Industry Association and a subcommittee of the Intermarket Surveillance Group when issues relating to the effects of futures and option trading on the stock market are discussed. Additionally, Professor Stoll discussed the findings of his study with the members of the Commission's Financial Products Advisory Committee at the Committee's recent meeting in Washington.

The Commission hopes that this discussion of our activities on this important issue will be helpful to your subcommittee. We intend to keep the subcommittee advised of any significant developments in this area.

Sincerely,

SUSAN M. PHILLIPS, *Chairman.*

ADMINISTRATION POSITION

The views of the Commodity Futures Trading Commission on H.R. 4613, the Futures Trading Act of 1986, are set forth in the following letters to the Committee on Agriculture:

COMMODITY FUTURES TRADING COMMISSION,
Washington, DC, April 25, 1986.

Hon. E (KIKA) DE LA GARZA,
Chairman, Committee on Agriculture,
U.S. House of Representatives, Washington, DC.

DEAR MR. CHAIRMAN: The Commodity Futures Trading Commission is pleased to submit its comments on H.R. 4613, a bill to reauthorize appropriations to carry out the Commodity Exchange Act, and to make technical improvements to that Act.

The Commission generally supports the provisions of this bill, which in many respects parallel those which the Commission had submitted to your Committee for its consideration. In particular, the Commission supports the bill's provisions that clarify that the Act's principal anti-fraud provision, Section 4b, applies to the marketing of off-exchange futures contracts in the United States, that permit the Commission to proceed in court on an ex parte basis to obtain the appointment of a temporary receiver, that assure that the Commission will be in a position, in appropriate circumstances, to have its subpoenas served outside the United States, and that relax the prohibitions in current law concerning permissible investments by Commissioners and Commission employees. Similarly, the Commission is pleased with the bill's provisions concerning registered futures associations, particularly the streamlining of the rule review process, the authority granted to the Commission to alter or supplement association rules and the clarifications of the procedures and standards to be employed in connection with Commission review of association membership and disciplinary actions.

The Commission regrets, however, that two of its proposals were not included in H.R. 4613. The Commission hopes that the members of the Committee will consider amending the bill to include these proposals and will review the following comments as reflective of our desire to provide a sound statutory scheme for the fair and effective regulation of the futures markets.

1. Leverage Transactions. The Commission believes that leverage transactions are legally and economically indistinguishable from

futures contracts and therefore do not warrant the special statutory treatment afforded by present law. Consistent with Congress' historical requirements that futures be traded on exchanges, the Act should be amended to remove leverage as a form of permissible over-the-counter commodity instrument. The existing statutory scheme creates confusion since the Commission enforces the Act's prohibition against off-exchange futures against many firms but must regulate a small number of leverage firms. This form of regulation is highly resource intensive due to the absence of self-regulatory safeguards and the fact that off-exchange commodity trading has been shown to be fraught with customer abuse. The Commission therefore requests that your Committee amend H.R. 4613 in a manner similar to S. 2045, as reported by the Senate Committee on Agriculture, Nutrition, and Forestry, to provide for the phaseout of separate leverage regulation under the Act over a two-year period.

2. Appellate review. As you know, the Commission had proposed that judicial review of all final Commission action occur in the Courts of Appeals. The Commission wishes to make clear that its proposal is neither unique nor novel and would not deprive parties of adequate judicial process in challenging Commission regulations and other actions. Rather, it is the existing Commodity Exchange Act that differs significantly from other regulatory statutes. The actions of most other agencies, including their rulemaking activities, are reviewable in the first instance directly in the Courts of Appeals. Examples include the Federal Communications Commission, the Nuclear Regulatory Commission, the Interstate Commerce Commission, the Federal Reserve Board, the Federal Energy Regulatory Commission, the Federal Labor Relations Authority, and virtually all actions taken by the Securities and Exchange Commission. As in the case of these agencies, Court of Appeals review of CFTC actions would save both agency and judicial as well as private parties resources by eliminating an unnecessary layer of review in the district court.

Moreover, we wish to emphasize that the Commission always develops a complete factual record and has stated the basis for its decision. Nothing is gained by trial level review of that record and decision, followed by an identical Court of Appeals review. In fact, a Court of Appeals is better equipped than a district court to review an agency's record and reasons for its decisions because district courts usually conduct trials and hear new evidence. This is not done in review of agency action. In the past, the Commission has had a number of appeals filed in district court from its review of exchange disciplinary actions, as well as district court challenges to its industry-wide or exchange-specific rulemaking initiatives. None of these cases permitted new evidence to be heard in the District Court, and virtually all of these cases were eventually appealed to the Court of Appeals.

Finally, Court of Appeals review assures a more prompt and certain regulation of the industry. If the Commission's action is sustained by the Court of Appeals, the Commission decision takes effect without delay of a second layer of review. If, on the other hand, the Commission had compiled an inadequate record or otherwise erred in its decision, a Court of Appeals can quickly remand the case to the Commission for corrective action.

With regard to an estimate of the cost of enacting this legislation, it is expected that it will have litle impact on the Commission's resources at the present time or over the next five years due to the fact that its provisions are largely clarifying amendments to the Commodity Exchange Act. The Commission also notes, however, that H.R. 4613 provides only for a three-year reauthorization period unlike the six-years the Commission had proposed and which have been provided in S. 2045. We believe the three-year period is much too short, in view of the Commission resources required in a reauthorization process. Further, given the Commission's maturity and twelve years of experience since it was created in 1974, a complete review of all provisions of the Commodity Exchange Act, the Commission, or its rules and regulations in such short intervals is not now necessary or appropriate. Of course, as in the past, the Commission stands ready at any time to appear before your Committee as it continues its active oversight of the Commission's performance.

Please be assured that the concerns stated above with these aspects of H.R. 4613 do not in any way detract from our support of the balance of the provisions of this bill.

Sincerely,

SUSAN M. PHILLIPS, *Chairman.*

COMMODITY FUTURES TRADING COMMISSION,
Washington, DC, April 25, 1986.

Hon. E (KIKA) DE LA GARZA,
Chairman, Committee on Agriculture,
U.S. House of Representatives, Washington, DC.

DEAR MR. CHAIRMAN: As you know, Chairman Susan Phillips has recently informed you by letter dated April 25, 1986 of the Commission's official views on several issues regarding our current reauthorization legislation. Generally, these views reflect a unanimous consensus among the five Commission members. On one issue, however, that of continuing Commission regulation of leverage, there was extensive discussion within the Commisison resulting in a split vote on our final proposal to Congress. This issue was a matter of considerable debate at the April 22 markup of the Subcommittee on Conservation, Credit, and Rural Development, and several Subcommittee members cited the Commission's division on leverage in their remarks. Since the leverage issue may continue to occupy the Committee's attention during the remainder of the reauthorization process, we felt it would be useful to highlight for the Committee the nature of the Commission's internal deliberations on leverage as reflected in Chairman Phillip's testimony to the Subcommittee on Conservation, Credit, and Rural Development on March 18, 1986:

"In the process of formulating its legislative proposal on leverage, the Commission also considered two alternatives to eliminating leverage transactions from regulation under the Act: retaining, and perhaps codifying, the existing moratoria; and lifting the moratoria, provided NFA or another registered futures association would share responsibility for regulating and policing an expanded leverage industry.

"No commissioner favored the alternative of retaining the existing statutory or regulatory scheme. However, should the Congress wish to do so, the Commision would respectfully request that the Congress, whether by statutory enactment or report language, support the Commission's existing moratoria provisions.

"Two Commissioners favored an alternative plan under which the moratoria could be gradually lifted, provided the NFA or another registered futures association would share with the Commission the responsibility for regulating or policing an expanded leverage industry. However, before any modification of the moratoria could be made, substantial study of the impact upon and resource applications for both the Commission and NFA would need to occur.

"In summary, because the Commission is concerned with the expansion of off-exchange instruments and the required commitment of resources which could otherwise be dedicated to overseeing the futures industry, the Commission recommends that leverage regulation be deleted from the Commodity Exchange Act. In any event, the Commission assures the Committee that these alternatives were thoroughly discussed and that the Commission will fully cooperate with whatever the Congress should decide on this matter."

We hope this information is useful to the Committee in its further deliberations on the leverage issue, and stand ready to provide any further assistance that you may require.

Sincerely,

Fowler C. West,
Commissioner.
William E. Seale,
Commissioner.

Commodity Futures Trading Commission,
Washington, DC, May 1, 1986.

Hon. Ed Jones,
Chairman, Subcommittee on Conservation, Credit, and Rural Development, Committee on Agriculture, U.S. House of Representatives, Washington, DC.

Dear Mr. Chairman: As you are aware, Section 3 of H.R. 4613 would amend Section 6(b) of the Commodity Exchange Act expressly to empower the Commission to serve administrative subpoenas on persons located outside the United States. During the April 22 mark-up on H.R. 4613 before the Subcommittee on Conservation, Credit, and Rural Development, Congressman Daschle expressed some concern that the scope of the Commission's extraterritorial subpoena authority would exceed the authority conferred upon the United States Department of Justice ("Justice") and the Federal Trade Commission ("FTC") to serve "civil investigative demands" or "CIDs" extraterritorially. See 15 U.S.C. § 1312(d)(2); 15 U.S.C. § 57b-1(c). I am writing this letter to expand upon the responses that I made to Congressman Daschle at that time.

CIDs and the Commission's requested subpoena authority are parallel courses for the obtaining of needed investigatory evidence. In order to clarify any uncertainty about the scope of our proposal, we intend that the use of Commission extraterritorial subpoenas would be limited to the pre-complaint, investigatory stage of enforcement proceedings. As a result, the scope of our requested subpoena authority would be very similar to that which presently exists for CIDs. We would not object to appropriate report language to make this clear. Moreover, there is an additional procedural safeguard for the issuance of a Commission subpoena. Under H.R. 4613, the full Commission must approve the issuance of an extraterritorial subpoena, while CIDs can be issued by a single individual.

We take issue with the assertion that a Commission subpoena could be enforced in violation of due process of law. Section 3 of H.R. 4613 does not alter the existing provision of Section 6(b) of the Act which requires that the Commission seek the aid of a United States district court to enforce an administrative subpoena, just as Justice and the FTC must resort to the federal district courts to enforce CIDs. The Court in any such enforcement action would give appropriate consideration to any due process defenses raised by respondents.

We believe that the proposed amendment to Section 6(b) of the Commodity Exchange Act is necessary in light of the decision of the United States Court of Appeals for the District of Columbia Circuit in *CFTC* v. *Nahas,* 738 F.2d 487 (D.C. Cir. 1984). *Nahas* held that Section 6(b) in its present form does not grant the Commission authority to serve investigative subpoenas outside the territorial limits of the United States. An amendment to Section 6(b) like that which we have proposed will make explicit the existence of that power. A similar approach was taken by Congress in 1976 when the existing statute governing CIDs in antitrust investigations conducted by Justice was amended expressly to provide for extraterritorial service of CIDs. Without the subpoena authority we have requested, the Comisssion might be foreclosed from investigating the conduct of foreign participants in the domestic futures markets, regardless of the magnitude of their involvement in those markets. Would-be violators of the Act who trade on U.S. markets might therefore be able to escape the Commission's enforcement authority simply by conducting their transactions on the American exchanges from abroad.

In closing, we repeat our assurances that the Commission's authority to issue extraterritorial subpoenas embodied in H.R. 4613 would not be used routinely. Where appropriate, the Commission would consult with the State Department to find a means of contacting foreign nationals in a manner that would seek to avoid offending a foreign nation. In addition, where there are particular treaties or governmental mutual assistance guarantees, the Commission would utilize them to the extent practicable to obtain essential documents or testimony.

Sincerely yours,

SUSAN M. PHILLIPS, *Chairman.*

BUDGET ACT COMPLIANCE (SECTION 308 AND SECTION 403)

The provisions of clause 2(l)(3)(B) of Rule XI of the Rules of the House of Representatives and section 308(a) of the Congressional Budget Act of 1974 (relating to estimates of new budget authority or new or increased tax expenditures) are not considered applicable. The estimate and comparison required to be prepared by the Director of the Congressional Budget Office under clause 2(l)(3)(C) of Rule XI of the Rules of the House of Representatives and section 403 of the Congressional Budget Act of 1974 submitted to the Committee prior to the filing of this report are as follows:

U.S. CONGRESS,
CONGRESSIONAL BUDGET OFFICE,
Washington, DC, May 28, 1986.

Hon. E DE LA GARZA,
Chairman, Committee on Agriculture,
U.S. House of Representatives, Washington, DC.

DEAR MR. CHAIRMAN: The Congressional Budget Office has prepared the attached cost estimate for H.R. 4613, the Futures Trading Act of 1986.

If you wish further details on this estimate, we will be pleased to provide them.

With best wishes,

Sincerely,

RUDOLPH G. PENNER, *Director.*

CONGRESSIONAL BUDGET OFFICE COST ESTIMATE

1. Bill number: H.R. 4613.
2. Bill title: Futures Trading Act of 1986.
3. Bill status: As ordered reported by the House Committee on Agriculture, May 7, 1986.
4. Bill purpose: H.R. 4613 would authorize the appropriation of such sums as may be necessary in each of the fiscal year 1987 through 1989 to carry out the activities of the Commodity Futures Trading Commission (CFTC).

The bill would require the CFTC to issue regulatons, within 90 days of the bill's passage, to make permanent its pilot program for trading commodity options on contract markets. The bill would also require that, two years of the bill's passage, the commission conduct a survey of persons interested in engaging in leverage transactions. The commission would be required to submit a report to the Congress of the survey's results along with regulations developed to govern leverage transactions entered into after the bill's passage. The commission would be authorized to delegate the regulation of these transactions to a registered futures association.

Fiscal year 1986 funding to date for the CFTYC is $28.0 million, after the reductions required by the Balanced Budget and Emergency Deficit Control Act of 1985. The President is requesting $30.4 million for fiscal year 1987 for these activities.

5. Estimated cost to the Federal Government:

[By fiscal years, in millions of dollars]

	1987	1988	1989	1990	1991
Estimated authorization level	28.4	29.2	30.8		
Estimated outlays	25.7	29.1	30.6	3.0	

Including outlays from prior years' appropriations to date, total outlays in fiscal year 1987 are estimated to be $28.4 million.

The costs of this bill fall within budget function 370.

Basis of estimate: In the absence of a specific authorization and because the CFTC expects to maintain its current activity level in fiscal year 1987, the CBO baseline has been used to estimate the authorization level and outlays for that year. Additional authorizations totaling $0.3 million in 1988 and $1.3 million in 1989 have been added to the baseline to cover the additional estimated costs to the CFTC of conducting the survey and providing oversight of leverage transaction activities as required in the bill. Outlays have been estimated based on historical spending patterns for the CFTC.

6. Estimated cost to State and local governments: None.

7. Estimate comparison: None.

8. Previous CBO estimate: On April 24, 1986, CBO prepared a cost estimate for S. 2045, the Futures Trading Act of 1986, as ordered reported by the Senate Commission on Agriculture, Nutrition and Forestry. That bill, which reauthorized the CFTC for the fiscal years 1987 through 1991, was similar but not identical to H.R. 4613.

9. Estimate prepared by: Theresa Gullo

10. Estimate approved by: C.G. Nuckols (for James L. Blum, Assistant Director for Budget Analysis).

INFLATIONARY IMPACT STATEMENT

Pursuant to clause 2(l)(4) of Rule XI of the Rules of the House of Representatives, the Committee estimates that enactment of H.R. 4613, as amended, will have no inflationary impact on the national economy.

OVERSIGHT STATEMENT

No summary of oversight findings and recommendations made by the Committee on Government Operations under clause 2(b)(2) of Rule X of the Rules of the House of Representatives was available to the Committee with reference to the subject matter specifically addressed by H.R. 4613, as amended.

No specific oversight activities other than the hearings detailed in this report were conducted by the Committee within the definition of clause 2(b)(1) of Rule X of the Rules of the House of Representatives.

CHANGES IN EXISTING LAW MADE BY THE BILL, AS REPORTED

In compliance with clause 3 of rule XIII of the Rules of the House of Representatives, changes in existing law made by the bill, as reported, are shown as follows (existing law proposed to be omitted is enclosed in black brackets, new matter is printed in italic, existing law in which no change is proposed is shown in roman):

COMMODITY EXCHANGE ACT

* * * * * * *

SEC. 4b. It shall be unlawful (1) for any member of a contract market, or for any correspondent, agent, or employee or any member, in or in connection with any order to make, or the making of, any contract of sale of any commodity in interstate commerce, made, or to be made, on or subject to the rules of any contract market, for or on behalf of any other person, or (2) for any person, in or in connection with any order to make, or the making of, any contract of sale of any commodity for future delivery, made, or to be made, [on or subject to the rules of any contract market,] for or on behalf of any other person if such contract for future delivery is or may be used for (a) hedging any transaction in interstate commerce in such commodity or the products or by products thereof, or (b) determining the price basis of any transaction in interstate commerce in such commodity, or (c) delivering any such commodity sold, shipped, or received in interstate commerce for the fulfillment thereof—

(A) to cheat or defraud or attempt to cheat or defraud such other person;

(B) willfully to make or cause to be made to such other person any false report or statement thereof, or willfully to enter or cause to be entered for such person any false record thereof;

(C) willfully to deceive or attempt to deceive such other person by any means whatsoever in regard to any such order or contract or the disposition or execution of any such order or contract, or in regard to any act of agency peformed with respect to such order or contract for such person; or

(D) to bucket such order, or to fill such order by offset against the order or orders of any other persons, or willfully and knowingly and without the prior consent of such person to become the buyer in respect to any selling order of such person, or become the seller in respect to any buying order of such person.

Nothing in this section or in any other section of this Act shall be construed to prevent a futures commission merchant or floor broker who shall have in hand, simultaneously, buying and selling orders at the market for different principals for a like quantity of a commodity for future delivery in the same month, from executing such buying and selling orders at the market price: *Provided,* That any such execution shall take place on the floor of the exchange where such orders are to be executed at public outcry across the ring and shall be duly reported, recorded, and cleared in the same manner as other orders executed on such exchange. : *And provided further,* That such transactions shall be made in accordance with such rules and regulations as the Commission may promulgate regarding the manner of the execution of such transactions.

Nothing in this section shall apply to any activity that occurs on a board of trade, exchange, market, or clearinghouse for such board of trade, exchange, or market, located outside the United States, its territories, or its possessions involving any contract of sale of a commodity for future delivery that is made, or to be made, on or subject to the rules of such board of trade, exchange, or market.

SEC. 4c. (a) It shall be unlawful for any person to offer to enter into, enter into, or confirm the execution of, any transaction involving any commodity, which is or may be used for (1) hedging any transaction in interstate commerce in such commodity or the products or byproducts thereof, or (2) determining the price basis of any such transaction in interstate commerce in such commodity, or (3) delivering any such commodity sold, shipped, or received in interstate commerce for the fulfillment thereof—

(A) if such transaction is, is of the character of, or is commonly known to the trade as, a "wash sale," "cross trade", or "accommodation trade", or is a fictitious sale; or

(B) if such transaction is used to cause any price to be reported, registered, or recorded which is not a true and bona fide price.

Nothing in this section shall be construed to prevent the exchange of futures in connection with cash commodity transactions or of futures for cash commodities, or of transfer trades or office trades if made in accordance with board of trade rules applying to such transactions and such rules shall have been approved by the Commission.

(b) No person shall offer to enter into, enter into or confirm the execution of, any transaction involving any commodity regulated under this Act which is of the character of, or is commonly known to the trade as, an "option", "privilege", "indemnity", "bid," "offer", "put", "call", "advance guaranty", or "decline guaranty", contrary to any rule, regulation, or order of the Commission prohibiting any such transaction or allowing any such transaction under such terms and conditions as the Commission shall prescribe. Any such order, rule, or regulation may be made only after notice and opportunity for hearing, and the Commission may set different terms and conditions for different markets.

[(c) Notwithstanding the provisions of subsection (b) of this section, no person may, after the enactment of the Futures Trading Act of 1978, offer to enter into, enter into, or confirm the execution of any commodity option transaction involving any commodity regulated under this Act but not specifically set forth in section 2(a) of this Act prior to the enactment of the Commodity Futures Trading Commission Act of 1974, until (1) the Commission transmits to the House Committee on Agriculture and the Senate Committee on Agriculture, Nutrition, and Forestry documentation of its ability to regulate successfully such transactions, including a copy of the Commission's proposed rules and regulations, and (2) the expiration of thirty calendar days of continuous session of Congress after the date of such transmittal. With respect to any commodity regulated under this Act and specifically set forth in section (2)(a) of this Act prior to the date of enactment of the Commodity Futures Trading Commission Act of 1974, the Commission may, pursuant to the procedures set forth in this subsection, establish a pilot program for a period not to exceed three years to permit such commodity option transactions. The Commission may authorize commodity option transactions during the pilot program in as many commodities as will provide an adequate test of the trading of such option transactions. After completion of the pilot program, the Commission may authorize commodity option transactions without regard to the restrictions in the pilot program after the Commission transmits to the House Committee on Agriculture and the Senate Committee on Agriculture, Nutrition, and Forestry the documentation required under clause (1) of the first sentence of this subsection and the expiration of thirty calendar days of continuous session of Congress after the date of such transmittal. The Commisson is not precluded from transmitting, at any time, documentation relating to its ability to regulate such transactions regarding individual commodities, classes of commodities, or regulation of such transactions on specific boards of trade. Nothing in this subsection shall affect any rights or obligations arising out of any transactions subject to the provisions of this subsection entered into, or the execution of which was confirmed, prior to October 1, 1978: *Provided,* That this prohibition shall not apply to any transaction expressly permitted under rules or regulations prescribed by the Commission, before or after the date of enactment of the Commodity Futures Trading Act of 1978, to be offered to be entered into, entered into, or confirmed, in which the purchaser is a producer, processor, commercial user of, or a merchant handling, the commodity involved in the transaction, or the products or byproducts thereof.]

(c) Not later than 90 days after the date of the enactment of the Futures Trading Act of 1986, the Commission shall issue regulations—

(1) to eliminate the pilot status of its program for the trading of commodity options on contract markets, including any numerical restrictions on the number of commodities or option contracts for which a contract market may be designated; and

(2) otherwise to continue to permit the trading of such commodity options under such terms and conditions that the Commission from time to time may prescribe.

(d) Notwithstanding the provisions of subsection (c) of this section—

(1) any person domiciled in the United States who on May 1, 1978, was in the business of granting an option on a physical commodity, other than a commodity specifically set forth in section 2(a) of this Act prior to enactment of the Commodity Futures Trading Commission Act of 1974, and was in the business of buying, selling, producing, or otherwise using that commodity, may continue to grant or issue options on that commodity in accordance with Commission regulations in effect on August 17, 1978, until thirty days after the effective date of regulations issued by the Commission under clause (2) of this subsection: *Provided,* That if such person files an application for registration under the regulations issued under clause (2) of this subsection within thirty days after the effective date of such regulations, that person may continue to grant or issue options pending a final determination by the Commission on the application; and

(2) the Commission shall issue regulations that permit grantors and futures commission merchants to offer to enter into, or confirm the execution of any commodity option transaction on a physical commodity subject to the provision of subsection (b) of this section, other than a commodity specifically set forth in section 2(a) of this Act prior to enactment of the Commodity Futures Trading Commission Act of 1974, if—

(A) the grantor is a person domiciled in the United States who—

(i) is in the business of buying, selling, producing, or otherwise using the underlying commodity;

(ii) at all times has a net worth of at least $5,000,000 certified annually by an independent public accountant using generally accepted accounting principles;

(iii) notifies the Commission and every futures commission merchant offering the grantor's option if the grantor knows or has reason to believe that the grantor's net worth has fallen below $5,000,000;

(iv) segregate daily, exclusively for the benefit of purchasers, money, exempted securities (within the meaning of section 3(a)(12) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(12), commercial paper, bankers' acceptances, commercial bills, or unencumbered warehouse receipts, equal to an amount by which the value of each transaction exceeds the amount received or to be received by the grantor for such transaction;

(v) provides an identification number for each transaction; and

(vi) provids confirmation of all orders for such transactions executed, including the execution price and a transaction identification number;

(B) the futures commission merchant is a person who—

(i) has evidence that the grantor meets the requirements specified in subclause (A) of this clause;

(ii) treats and deals with all money, securities, or property received from its customers as payment of the purchase price in connection with such transactions, as belonging to such customers until the expiration of the term of the option, or, if the customer exercises the option, until all rights of the customer under the commodity option transaction have been fulfilled;

(iii) records each transaction in its customer's name by the transaction identification number provided by the grantor;

(iv) provides a disclosure statement to its customers, under regulations of the Commission, that discloses, among other things, all costs, including any markups or commissions involved in such transaction; and

(C) the grantor and futures commission merchant comply with any additional uniform and reasonable terms and conditions the Commission may prescribe, including registration with the Commission.

The Commission may permit persons domiciled in the United States to grant options under this subsection, other than options on a commodity specifically set forth in section (2)(a) of this Act prior to enactment of the Commodity Futures Trading Commission Act of 1974, under such additional rules, regulations, and orders as the Commission may adopt to provide protection to purchasers that are substantially the equivalent of those applicable to grantors domiciled in the United States. The Commission may terminate the right of any person to grant, offer, or sell options under this subsection only after a hearing, including a finding that the continuation of such right is contrary to the public interest: *Provided,* That pending the completion of such termination proceedings, the Commission may suspend the right to grant, offer, or sell options of any person whose activities in the Commission's judgment present a substantial risk to the public interest.

(e) The Commission may adopt rules and regulations, after public notice and opportunity for a hearing on the record, prohibiting the granting, issuance, or sale of options permitted under subsection (d) of this section if the Commission determines that such options are contrary to the public interest.

(f) Nothing in this Act shall be deemed to govern or in any way be applicable to any transaction in an option on foreign currency traded on a national securities exchange.

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Sec. 6. * * *

(b) If the Commission has reason to believe that any person (other than a contract market) is manipulating or attempting to manipulate or has manipulated or attempted to manipulate the market price of any commodity, in interstate commerce, or for future delivery on or subject to the rules of any contract market, or has willfully made any false or misleading statement of a material fact in any registration application or any report filed with the Commission under this Act, or willfully omitted to state in any such application or report any material fact which is required to be stated therein, or otherwise is violating or has violated any of the provisions of this Act or of the rules, regulations, or orders of the Secretary of Agriculture or the commission thereunder it may serve upon such person a complaint stating its charges in that respect, which complaint shall have attached or shall contain therein a notice of hearing, specifying a day and place not less than three days after the service thereof, requiring such person to show cause why an order should not be made prohibiting him from trading on or subject to the rules of any contract market, and directing that all contract markets refuse all trading privileges to such person, until further notice of the Commission, and to show cause why the registration of such person, if registered, with the Commission in any capacity, should not be suspended or revoked. Said hearing may be held in Washington, District of Columbia or elsewhere, before the Commission, or before an Administrative Law Judge designated by the Commission, which Administrative Law Judge shall cause all evidence to be reduced to writing and forthwith transmit the same to the Commission. For the purpose of securing effective enforcement of the provisions of this Act and for the purposes of any investigation or proceeding under this Act, any member of the Commission or any Administrative Law Judge or other officer designated by the Commission (*except as provided in the proviso to the following sentence*) may administer oaths and affirmations, subpena witnesses, compel their attendance, take evidence, and require the production of any books, papers, correspondence, memoranda, or other records that the Commission deems relevant or material to the inquiry. The attendance of witnesses and the production of any such records may be required from any place in the United States **[**or any State**]**, *any State, or any foreign* *country or jurisdiction* at any designated place of hearing; *and a subpena issued under this subsection may be served on any person who is not to be found within the territorial jurisdiction of any court of the United States in such manner as the Federal Rules of Civil Procedure prescribe for service of process in a foreign country: Provided, That a subpena to be served on a person who is not to be found within the territorial jurisdiction of any court of the United States may be issued only on the prior approval of the Commission.* In case of contumacy by, or refusal to obey a subpena issued to, any person, the Commission may invoke the aid of any court of the United States within the jurisdiction in which the investigation or proceeding is conducted, or where such person resides or transacts business, in requiring the attendance and testimony of witnesses and the production of books, papers, correspondence, memoranda, and other records. Such court may issue an order requiring such person to appear before the Commission or member or Administrative Law Judge or other officer designated by the Commission, there to produce records, if so ordered, or to give testimony touching the matter under investigation or in question. Any failure to obey such order of the court may be punished by the court as a contempt thereof. All process in any such case may be served in the judicial district wherein such person is an inhabitant or transacts business or wherever such person may be found. Upon evidence received, the Commission may prohibit such person from trading on or subject to the rules of any contract market and require all contract markets to refuse such person all trading privileges thereon for such period as may be specified in the order, and, if such person is registered with the Commission in any capacity, may suspend, for a period not to exceed six months, or revoke, the registration of such person, and may assess such person a civil penalty of not more than $100,000 for each such violation. Notice of such order shall be sent forthwith by registered mail or by certified mail or delivered to the offending person and to the governing boards of said contract markets. After the issuance of the order by the Commission, as aforesaid, the person against whom it is issued may obtain a review of such order or such other equitable relief as to the court may seem just by filing in the United States circuit court of appeals of the circuit in which the petitioner is doing business, or in the case of an order denying registration, the circuit in which the petitioner's principal place of business listed on petitioner's application for registration is located, a written petition, within fifteen days after the notice of such order is given to the offending person praying that the order of the Commission be set aside. A copy of such petition shall be forthwith transmitted by the clerk of the court to the Commission and thereupon the Commission shall file in the court the record theretofore made, as provided in section 2112 of title 28, United States Code. Upon the filing of the petition the court shall have jurisdiction to affirm, to set aside, or modify the order of the Commission, and the findings of the Commission as to the facts, if supported by the weight of evidence, shall in like manner be conclusive.

SEC. 6c. Whenever it shall appear to the Commission that any contract market or other person has engaged, is engaging, or is about to engage in any act or practice constituting a violation of any provision of this Act or any rule, regulation, or order thereunder, or is restraining trading in any commodity for future delivery, the Commission may bring an action in the proper district court of the United States or the proper United States court of any territory or other place subject to the jurisdiction of the United States, to enjoin such act or practice, or to enforce compliance with this Act, or any rule, regulation or order thereunder, and said courts shall have jurisdiction to entertain such actions: *Provided,* That no restraining order (other than a restraining order which prohibits any person from destroying, altering or disposing of, or refusing to permit authorized representatives of the Commission to inspect, when and as requested, any books and records or other documents or which prohibits any person from withdrawing, transferring, removing, dissipating, or disposing of any funds, assets, or other property, *and other than an order appointing a temporary receiver to administer any books, records, documents, funds, assets, or other property that is subject to such restraining order and to perform such other duties as the court may consider appropriate*) or injunction for violation of the provisions of this Act shall be issued ex parte by said court. Upon a proper showing, a permanent or temporary injunction or restraining order shall be granted without bond. Upon application of the Commission, the district courts of the United States and the United States courts of any territory or other place subject to the jurisdiction of the United States shall also have jurisdiction to issue writs of mandamus, or orders affording like relief, commanding any person to comply with the provisions of this Act or any rule, regulation, or order of the Commission thereunder, including the requirement that such person take such action as is necessary to remove the danger of violation of this Act or any such rule, regulation, or order: *Provided,* That no such writ of mandamus, or order affording like relief, shall be issued ex parte. Any action under this section may be brought in the district wherein the defendant is found or is an inhabitant or transacts business or in the district where the act or practice occurred, is occurring, or is about to occur, and process in such cases may be served in any district in which the defendant is an inhabitant or wherever the defendant may be found. In lieu of bringing actions itself pursuant to this section, the Commission may request the Attorney General to bring the action. Where the Commission elects to bring the action, it shall inform the Attorney General of such suit and advise him of subsequent developments.

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SEC. 9. (a) * * *

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(d) It shall be a felony punishable by a fine of not more than $100,000 or imprisonment for not more than five years, or both, together with the costs of prosecution, for any Commissioner of the Commission or any employee or agent thereof, to participate, directly or indirectly, in any transaction in commodity futures or any transaction of the character of or which is commonly known to the trade as an "option", "privilege", "indemnity", "bid", "offer", "put", "call", "advance guarantee", or "decline guaranty", or any transaction for the delivery of any commodity under a standardized contract commonly known to the trade as a margin account, margin contract, leverage account, or leverage contract, or under any contract, account, arrangement, scheme, or device that the Commission determines serves the same function or functions as such a standardized contract, or is marketed or managed in substantially the same manner as such a standardized contract, or for any such person to participate, directly or indirectly, in any investment transaction in an actual commodity *if nonpublic information is used in the investment transaction, if the investment transaction is prohibited by rule or regulation of the Commission, or if the investment transaction is effected by means of any instrument regulated by the Commission.* ⟦Such prohibition against any investment transaction in an actual commodity shall not apply to (1) a transaction in which such person buys an agricultural commodity or livestock for use in such person's own farming or ranching operations or sells an agricultural commodity which such person has produced in connection with such person's own farming or ranching operations nor to any transaction in which such person sells livestock owned by such person for at least three months, (2) a transaction entered into by the trustee of a trust established by such person over which such person exercises no control if such transaction is entered into solely to hedge against adverse price changes in connection with such farming or ranching operations or is a transaction for the lease of oil or gas or other mineral rights or interests owned by such person, or (3) a transaction in which such person buys or sells, directly or indirectly (except by means of an instrument regulated by the Commission), a United States Government security, a certificate of deposit, or a similar financial instrument if no nonpublic information is used by such person in such transaction. With respect to such excepted transactions, the Commission shall require any Commissioner of the Commission or any employee or agent thereof who participates in any such transaction to notify the Commission thereof in accordance with such regulations as the Commission shall prescribe and the Commission shall make such information available to the public.⟧ *The foregoing prohibitions shall not apply to any transaction or class of transactions that the Commission, by rule or regulation, has determined would not be contrary to the public interest or otherwise inconsistent with the purposes of this section.*

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SEC. 12. (a)* * *

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⟦(d) There are hereby authorized to be appropriated to carry out the provisions of this Act such sums as may be required for each of the fiscal years during the period beginning October 1, 1982, and ending September 30, 1986.⟧

[1] *(d) There authorized to be appropriated to carry out this Act such sums as may be necessary for each of the fiscal years during*

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[1] This amendment becomes effective October 1, 1986.

the period beginning October 1, 1986, and ending September 30, 1989.

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SEC. 17. (a)* * *

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[(h) If any registered futures association takes any disciplinary action against any member thereof or any person associated with such a member or denies admission to any person seeking membership therein, or bars any person from being associated with a member, such action shall be subject to review by the Commission, on its own motion, or upon application by any person aggrieved thereby filed within thirty days after such action has been taken or within such longer period as the Commission may determine. Application to the Commission for review, or the institution of review by the Commission on its own motion, shall operate as a stay of such action until an order is issued upon such review pursuant to subsection (i) of this section unless the Commission otherwise orders, after notice and opportunity for hearing on the question of a stay (which hearing may consist solely of affidavits and oral arguments).

[(i) (1) In a proceeding to review disciplinary action taken by a registered futures association against a member thereof or a person associated with a member, if the Commission, after appropriate notice and opportunity for hearing, upon consideration of the record before the association and such other evidence as it may deem relevant—

[(A) finds that such member or person has engaged in such acts or practices, or has omitted such act, as the association has found him to have engaged in or omitted, and

[(B) determines that such acts or practices, or omission to act, are in violation of such rules of the association as have designated in the determination of the association, the Commission shall by order dismiss the proceeding, unless it appears to the Commission that such action should be modified in accordance with paragraph (2) of this subsection. The Commission shall likewise determine whether the acts or practices prohibited, or the omisison of any act required, by any such rule constitute conduct inconsistent with just and equitable principles of trade, and shall so declare. If it appears to the Commission that the evidence does not warrant the finding required in clause (A), or if the Commission determines that such acts or practices as are found to have been engaged in are not prohibited by the designated rule or rules of the association, or that such act as is found to have been omitted is not required by such designated rule or rules, the Commission shall by order set aside the action of the association.

[(2) If, after appropriate notice and opportunity for hearing, the Commission finds that any penalty imposed upon a member or person associated with a member is excessive or oppressive, having due regard to the public interest, the Commission shall by order cancel, reduce, or require the remission of such penalty.

[(3) In any proceeding to review the denial of membership in a registered futures association or the barring of any person from being associated with a member, if the Commission, after appropriate notice and hearing, and upon consideration of the record before the association and such other evidence as it may deem relevant, determines that the specific grounds on which such denial or bar is based exist in fact and are valid under this section, the Commission shall by order dismiss the proceeding; otherwise, the Commission shall by order set aside the action of the association and require it to admit the applicant to membership therein, or to permit such person to be associated with a member.]

(h)(1) If any registered futures association takes any final disciplinary action against a member thereof or a person associated with a member, or denies admission to any person seeking membership therein or bars any person from being associated with a member, the association promptly shall give notice thereof to such member or person and file notice thereof with the Commission. The notice shall be in such form and contain such information as the Commission, by rule or regulation, may prescribe as necessary or appropriate in furtherance of the purposes of this Act.

(2) Any action with respect to which a registered futures association is required by paragraph (1) of this subsection to file notice shall be subject to review by the Commission on its motion, or on application by any person aggrieved thereby. Such application shall be filed within thirty days after the date such notice is filed with the Commission and received by the aggrieved person, or within such longer period as the Commission may determine.

(3) Application to the Commission for review, or the institution of review by the Commission on its own motion, shall not operate as a stay of such action unless the Commission otherwise orders, summarily or after notice and opportunity for hearing on the question of a stay (which hearing may consist solely of the submission of affidavits or presentation of oral arguments). The Commission shall establish procedures for expedited consideration and determination of the question of a stay.

(i)(1) In a proceeding to review a final disciplinary action taken by a registered futures association against a member thereof or a person associated with a member, after appropriate notice and opportunity for a hearing (which hearing may consist solely of consideration of the record before the association and opportunity for the presentation of supporting reasons to affirm, modify, or set aside the sanction imposed by the association)—

(A) if the Commission finds that—

(i) the member or person associated with a member has engaged in the acts or practices, or has omitted the acts, that the association has found the member or person to have engaged in or omitted;

(ii) the acts or practices, or omissions to act, are in violation of the rules of the association specified in the determination of the association; and

(iii) such rules are, and were applied in a manner, consistent with the purposes of this Act;

the Commission, by order, shall so declare and, as appropriate, affirm the sanction imposed by the association, modify the *sanction in accordance with paragraph (2) of this subsection, or remand the case to the association for further proceedings; or*

(B) if the Commission does not make any such finding, the Commission, by order, shall set aside the sanction imposed by the association and, if appropriate, remand the case to the association for further proceedings.

(2) If after a proceeding in accordance with paragraph (1) of this subsection, the Commission finds that any penalty imposed on a member or person associated with a member is excessive or oppressive, having due regard for the public interest, the Commission, by order, shall cancel, reduce, or require the remission of the penalty.

(3) In a proceeding to review the denial of membership in a registered futures association or the barring of any person from being associated with a member, after appropriate notice and opportunity for a hearing (which hearing may consist solely of consideration of the record before the association and opportunity for the presentation of supporting reasons to affirm, modify, or set aside the action of the association)—

(A) if the Commission finds that—

(i) the specific grounds on which the denial or bar is based exist in fact;

(ii) the denial or bar is in accordance with the rules of the association; and

(iii) such rules are, and were applied in a manner, consistent with the purposes of this Act;

the Commission, by order, shall so declare and, as appropriate, affirm or modify the action of the association, or remand the case to the association for further proceedings; or

(B) if the Commission does not make any such finding, the Commission, by order, shall set aside the action of the association and require the association to admit the applicant to membership therein or permit the person to be associated with a member, or, as appropriate, remand the case to the association for further proceedings.

(4) Any person (other than a registered futures association) aggrieved by a final order of the Commission entered under this subsection may file a petition for review with a United States court of appeals in the same manner as provided in section 6(b) of this Act.

(j) Every registered futures association shall file with the Commission in accordance with such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest, copies of any changes in or additions to the rules of the association, and such other information and documents as the Commission may require to keep current or to supplement the registration statement and documents filed pursuant to subsection (a) of this section. A registered futures association shall submit to the Commission any change in or addition to its rules and may make such rules effective ten days after receipt of such submission by the Commission unless, within the ten-day period, the registered futures association requests review and approval thereof by the Commission or the Commission notifies such registered futures association in writing of its determination to review such rules for approval. [The Commission shall approve such rules within thirty days of their receipt if Commission approval is requested under this subsection or within thirty days after the Commission determines to review for approval any other rules unless the Commission notifies the registered futures association of its inability to complete such approval or review within such period of time.] The Commission shall approve such rules if such rules are determined by the Commission to be consistent with the requirements of this section and not otherwise in violation of this Act or the regulations issued pursuant to this Act, and the Commission shall disapprove, after appropriate notice and opportunity for hearing, any such rule which the Commission determines at any time to be inconsistent with the requirements of this section or in violation of this Act or the regulations issued pursuant to this Act. If the Commission does not approve or institute disapproval proceedings with respect to any rule within one hundred and eighty days after receipt or within such longer period of time as the registered futures association may agree to, or if the Commission does not conclude a disapproval proceeding with respect to any rule within one year after receipt or within such longer period as the registered futures association may agree to, such rule may be made effective by the registered futures association until such time as the Commission disapproves such rule in accordance with this subsection.

* * * * * * *

[SEC. 19. (a) No person shall offer to enter into, enter into, or confirm the execution of, any transaction for the delivery of any commodity specifically set forth in section 2(a) of this Act prior to the enactment of the Commodity Futures Trading Commission Act of 1974 under a standardized contract commonly known to the trade as a margin account, margin contract, leverage account, or leverage contract, or under any contract, account, arrangement, scheme, or device that the Commission determines serves the same function or functions as such a standardized contract, or is marketed or managed in substantially the same manner as such a standardized contract.

[(b) No person shall offer to enter into, enter into, or confirm the execution of any transaction for the delivery of silver bullion, gold bullion, or bulk silver coins or bulk gold coins, under a standardized contract described in subsection (a) of this section, contrary to any rule, regulation, or order of the Commission designed to ensure the financial solvency of the transaction or prevent manipulation or fraud: *Provided*, That such rule, regulation, or order may be made only after notice and opportunity for hearing.

[(c) The Commission shall regulate any transactions under a standardized contract described in subsection (a) of this section involving commodities described in subsection (b) of this section or any other commodities (except those commodities described in subsection (a) of this section) under such terms and conditions as the Commission shall prescribe by rule, regulation, or order made only after notice and opportunity for a hearing. The Commission may set different terms and conditions for such transactions involving different commodities. Notwithstanding any other provision of this section, the Commission may prohibit any transaction for the delivery of any commodity under a standardized contract described in subsection (a) of this section that is not permitted by the rules, regulations and orders of the Commission in effect on December 9, 1982, if the Commission determines that any such transactions would be contrary to the public interest.]

SEC. 19. (a) Except as authorized under subsection (b), no person shall offer to enter into, enter into, or confirm the execution of, any transaction for the delivery of any commodity under a standardized contract commonly known to the trade as a margin account, margin contract, leverage account, or leverage contract, or under any contract, account, arrangement, scheme, or device that the Commission determines serves the same function or functions as such a standardized contract, or is marketed or managed in substantially the same manner as such a standardized contract.

(b)(1) Subject to paragraph (2), no person shall offer to enter into, enter into, or confirm the execution of, any transaction for the delivery of silver bullion, gold bullion, bulk silver coins, bulk gold coins, or platinum under a standardized contract described in subsection (a) of this section, contrary to the terms of any rule, regulation, or order that the Commission shall prescribe, which may include terms designed to ensure the financial solvency of the transaction or prevent manipulation or fraud. Such rule, regulation, or order may be made only after notice and opportunity for hearing. The Commission may set different terms and conditions for transactions involving different commodities.

(2) No person may engage in any activity described in paragraph (1) of this subsection who is not permitted to engage in such activity by the rules, regulations, and orders of the Commission in effect on the date of the enactment of the Futures Trading Act of 1986, until the Commission permits such person to engage in such activity in accordance with regulations issued in accordance with subsection (c)(2) of this section.

(c)(1) Not later than 2 years after the date of the enactment of the Futures Trading Act of 1986, the Commission shall, with the assistance of a futures association registered under this Act, conduct a survey concerning the persons interested in engaging in the business of offering to enter into, entering into, or confirming the execution of, the transactions described in subsection (b)(1) of this section and shall transmit a report of the results of the survey to the Committee on Agriculture of the House of Representatives and the Committee on Agriculture, Nutrition, and Forestry of the Senate. Notwithstanding any other provision of law, for purposes of completing such report the Commission may direct, by rule, regulation, or order, a futures association registered under this Act to render such assistance as the Commission shall specify. Such report shall include the Commission's findings and any recommendations concerning—

(A) whether such transactions serve an economic purpose;

(B) the most efficient manner, consistent with the public interest, to permit additional persons to engage in the business of offereing to enter into, entering into, and confirming the execution of such transactions; and

(C) the appropriate regulatory scheme to govern such transactions to ensure the financial solvency of such transactions and to prevent manipulation or fraud.

(2) Such report shall also include Commission regulations governing such transactions. Such regulations shall provide for permitting

additional persons to engage in such transactions. Such regulations shall become effective on the expiration of 45 calendar days on which either House of Congress is in session after the date of the transmittal of such report to Congress. Such regulations—

(A) may authorize or require, notwithstanding any other provision of law, a futures association registered under this Act to perform such responsibilities in connection with such transactions as the Commission may specifiy; and

(B) may require that permission for additional persons to engage in such business be given on a gradual basis, so as not to place an undue burden on the resources of the Commission.

(d) This section shall not affect any rights or obligations arising out of any transaction subject to the provisions of this section, as in effect before the date of the enactment of the Futures Trading Act of 1986, that was entered into, or the execution of which was confirmed, before the date of the enactment of such Act.

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ADDITIONAL VIEWS OF HON. DAN GLICKMAN, THOMAS A. DASCHLE, HAROLD L. VOLKMER, CHARLES W. STENHOLM, SID MORRISON OF WASHINGTON, STEVE GUNDERSON, AND ROBERT F. SMITH OF OREGON

With reservations, we support H.R. 4613. We believe it is imperative that Congress reauthorize the Commodity Futures Trading Commission in a timely fashion. Futures and options trading has become an integral part of modern financial markets, and the CFTC has ably and responsibly met the challenge of incredible growth in such trading since the last reauthorization in 1982.

H.R. 4613 does not make major revisions in the Commodity Exchange Act; it does, however, fine-tune many of the Act's provisions. In addition, based on the testimony of the Commission and market users, language in the Committee's report expresses the Committee's views regarding several significant regulations and policies applicable to these markets. Those views encourage adoption of additional exemptions in certain instances from the Commission's commodity trading advisor registration regulations and a reexamination of the Commission's definition of hedging, speculative limits set by the CFTC and by the exchanges, and the Commission's policy on aggregation of positions. The report also includes language expressing the Committee's concern that contract markets regulated by the Act have governing bodies representative of users of the markets and the public.

H.R. 4613 includes, however, an amendment concerning the regulation of leverage contracts which we find objectionable. The issue of leverage contracts has been extremely complex and controversial ever since Congress first dealt with it in 1974, when the CFTC was established. In summary, section 19 of the Commodity Exchange Act grants these instruments a special exemption from the legislative and regulatory framework of the Act. H.R. 4613 continues that special exemption, in spite of recommendations to the contrary made by the CFTC and advocated by us during the Subcommittee's and Committee's consideration of the bill.

In its legislative recommendation for reauthorization, the CFTC proposed eliminating from the Act any special, preferential treatment of leverage contracts. In her written statement to the Committee, CFTC Chairman Phillips observed:

> Following its experience with leverage regulation, and in view of current constraints, the Commission now requests amendments that would eliminate federal leverage regulation, and would remove from the Act virtually all references to leverage transactions. The amendments would eliminate what the Commission perceives as the historical and unjustified statutory distinction between leverage and futures contracts. In the Commission's view, leverage

> transactions are legally and economically indistinguishable from futures contracts and therefore do not warrant separate statutory treatment.

The CFTC this year came to the same conclusion it had recommended in the past, and which several other experts, including the Chicago Board of Trade, the Chicago Mercantile Exchange, the Commodity Exchange, and the North American Securities Administrators Association, endorsed during the Subcommittee's reauthorization hearings: That is, leverage contracts are futures contracts. They are the same as other contracts regulated by the Act with one special exception, they are not required to be traded on exchanges, in violation of the cardinal principle of the Act.

During its consideration of the bill, the Subcommittee and Committee devoted more time to this issue than any other, with good reason. Leverage raises a question of major significance to the industry and to the Congress: Is it desirable to have an over-the-counter futures business, similar to the over-the-counter securities and bond markets?

Federal policy has answered negatively ever since Congress first legislated in this area over sixty years ago for three basic reasons: One, exchanges, regulated under the oversight of the CFTC, provide customer protection not available and not established for off-exchange trading, which has long been recognized as rife with consumer abuse; two, exchange trading is the only established mechansim for performing the fundamental purposes of futures and options trading, the opportunity for market users to hedge their risks in the cash market and for the price discovery function played by these markets; and three, centralized markets focus this type of economic activity in a way which benefits both market uses and those dependent on the information derived from the markets.

Proponents of the bill's leverage provisions argued that it would be contrary to the public interest to enact the CFTC's leverage recommendation because it would cause two businesses to cease operating. That this recommendation would have greatly altered those companies there is no question; however, there is considerable evidence to show that the companies could have, and would have, shifted to other lines of business, including ones which they currently offer, or would have restructured their business in accordance with other federal and state laws. The Commission's written statement on reauthorization noted that "the amendment would not necessarily terminate the business of these firms. . . [they] could, albeit with some modifications to their operations, continue in business * * * "

The existence of leverage trading, which is done only by two companies operating under a special grandfather provision of CFTC regulations, undermines the Act's legislative and regulatory structure. Continuing, even if only for two years, this special treatment for only two firms, as this bill does, grants preferential treatment, amounting to a virtual federally-approved monopoly, which is anticompetitive with respect to firms which may be interested in getting into the business. This bill's treatment of leverage fails to act affirmatively with the issue and begs the question of how Congress should deal forthrightly with an over-the-counter futures and options market. In short, rather than a positive answer to these very complex questions, which were laid out extensively before the Subcommittee and Committee, the bill delays answering the fundamental question concerning this issue, assuring that it will be before the Committee again.

Furthermore, the bill's treatment of leverage is internally inconsistent and duplicative. First, while acceding to the leverage proponent's arguments to protect the existing firms' lines of business, it strips them of the ability to offer leverage contracts on certain commodities they now sell. Thus, the bill accepts the disputed notion that leverage trading provides a competitive force for organized and regulated exchanges, but it grants special protection from those competitive forces for the exchanges which trade contracts which may no longer be offered under the provisions of H.R. 4613.

Second, the bill requires the CFTC, in cooperation with the industry's self-regulatory body, the National Futures Association, to study and to report to Congress on expanding the leverage business. The report is to include a survey of persons interested in becoming involved in the business; a study of whether leverage serves an "economic purpose' (a test required of other instruments under the purview of the Act); recommendations on how an expanded leverage business can be regulated consistent with the public interest; and the appropriate regulatory structure to govern such transactions. As noted, the CFTC has already recommended to Congress that leverage not be expanded. the Commission also determined specifically in its legislative recommendations that leverage does not meet the same economic purpose test as other contracts. Finally, the CFTC has repeatedly stated to the Committee during hearings on H.R. 4613 and oversight hearings of off-exchange trading that it does not have resources to regulate an expanded leverage business and therefore should not, coupled with other reasons, act on its own to allow new entrants into the business.

Third, in its report to Congress, the Commission is to submit regulations for governing an expanded leverage business. Those regulations are to be implemented after the appropriate Congressional Committees have the opportunity to review them. In short, the bill calls on the CFTC to study expanding this activity, and then to proceed to allow its expansion, even if the report's findings should indicate that it is not in the public interest to do so.

While these provisions on leverage are disturbing; the bill, the clarifying statements included in the Committee's report on the CFTC's power to serve investigatory subpeonas outside the United States, the CFTC's ability to assert jurisdiction over fraudulent activities occuring outside the United States, and the Committee's endorsement of the performance of the NFA during the past four years, and the other report language on matters noted above merit the House approval. We must, however, call to the attention of our colleagues our strong reservations and objections to the bill's treatment of leverage.

THOMAS A. DASCHLE.
CHARLIE STENHOLM.
STEVE GUNDERSON.
DAN GLICKMAN.
HAROLD L. VOLKMER.
SID MORRISON.
BOB SMITH.

ADDITIONAL AND DISSENTING VIEWS OF HON. GLENN ENGLISH

The principal issue discussed at Committee markup on this legislation was the subject of leverage contracts. At the markup session, I established through a series of questions and answers with CFTC Chairman Phillips, that leverage contracts and futures contracts are identical as a matter of law and economics. I also established, however, based upon the answers of the CFTC, that the regulatory scheme in place now for leverage provides few of the public protections in place for futures contracts. This disparity stems from the fact that by law futures must be traded under the self-regulatory programs of the exchanges, while leverage contracts are traded off-exchange with the leverage firm acting as a principal to each customer transaction.

Since it is my view that all comparable products should be subjected to the same regulation, I supported the Glickman Amendment to require the regulation of all leverage contracts in the same manner as futures contracts. I adopted this position not because I was intent on putting the two existing leverage firms out of business. Rather, I simply want all firms selling futures contracts to the public to comply with the same rules. This policy promotes public protection and regulatory efficiency, while also preserving market integrity.

Unfortunately, the Glickman Amendment was defeated. The opponents of the Glickman Amendment argued that leverage contracts were not futures contracts because leverage customers purchase leverage contracts in gold, silver and platinum as investments in these precious metals. The opponents of the Glickman Amendment structured a purported compromise, which was adopted by the Committee, that will require the CFTC to authorize within two years expanded leverage activity in gold, silver and platinum. Although no other commodities may be the subject of leverage contracts under this Amendment, the CFTC estimated that opening leverage in this manner may require doubling their existing resources.

I believed that this so-called compromise Amendment could lead to a customer protection disaster. Theoretically under the Amendment, leverage contracts could be sold out of every pawn shop and store front in America. The potential financial injury inflicted on the American public through this burgeoning off-exchange activity is staggering.

In an attempt to address this problem, I proposed to add to the Committee bill on leverage a section enlisting the assistance of state law enforcement officials in enforcing state statutes, rules, and regulations to deal with the leverage situation. Under my Amendment, the Commission would establish the minimum regulatory criteria that a leverage firm would be required to meet, and states would be free to adopt additional regulatory requirements as dictated by the needs of those particular states.

The approach reflected in my Amendment was not unique. As explained by Representative Edward Madigan, the ranking Minority Member of the Committee, my Amendment would "simply give to the states an authority equal to that to which the states presently have over all off-exchange activities but which they do not have with regard to leverage contracts. We would be bestowing upon them an authority equal to what they otherwise have." At markup, Representative Madigan also suggested, and I agreed, that the two parts of my Amendment be separated for purposes of voting so that the section of the Amendment that appeared to present legal and jurisdictional questions would be voted upon separately and apart from the Amendment that would accomplish the purpose Mr. Madigan accurately and succinctly described in the above quotation. I agreed to Mr. Madigan's suggestion. The Committee rejected that part of my Amendment that possibly could have created a jurisdictional issue, and adopted that part of my Amendment that would have deputized states to enforce state statutes, rules and regulations in the leverage area.

At the conclusion of the markup, Committee counsel pointed out that certain technical drafting changes might be required to perfect my Amendment. I agreed at that time to work with Committee counsel and Mr. Madigan to perfect the Amendment in order to ensure that it conformed precisely to the Committee's intent. At that time, the Committee Chairman advised the Commmittee that the Committee counsel and the CFTC would work with me and Representative Madigan to redraft the Amendment. In addition, the Chairman explained "if necessary, we will bring it before the Committee. If it doesn't change the basic policy or structure and it is just reworded we will advise the Committee nonetheless."

I presumed from the Chairman's remarks that if our redrafting efforts were successful and Mr. Madigan and I could accept the revised text of the Amendment which did not "change the basic policy or structure" of the Amendment, it would not be necessary to reconvene a markup session on my Amendment.

Following the markup, I worked with Representative Madigan as well as counsel for the Committee and the CFTC to develop a revised text of my Amendment that accurately captured the Committee's intent in adopting my Amendment as expressed by Representative Madigan during the markup session on May 7, 1986. This amendment would have made clear that state statutes, rules and regulations that were not contrary to the requirements of the Commodity Exchange Act or the Commission's regulations could be applied and enforced by state officials with respect to leverage contracts. This Amendment would have treated leverage contracts in the same manner as all other forms of non-prohibited, off-exchange commodity instruments. The states' authority would have been no more or no less in leverage than it is in these other areas. I presumed that our redrafted Amendment could simply be circulated to the Committee members for notification prior to its inclusion in the final Committee Report on this bill.

I was therefore surprised to learn that a new markup session had been scheduled on my Amendment for May 21, 1986. It appears that the catalyst for this rescheduled markup was a letter from CFTC Chairman Phillips to the Chairman of this Committee as well as the ranking Minority Member, Representative Madigan. In this letter, the Commission took the position that an earlier version of my redrafted Amendment did not accurately reflect the Committee's intent at the markup on May 7. Significantly, the Commission's analysis does not quote or cite the plain and unmistakable statement of the Committee's intent by Representative Madigan that occurred prior to the vote on my Amendment and which is quoted above. Instead, the Commission's conclusion was based solely on precedent of its own invention and not on the views of any Member of this Committee.

The CFTC also proposed an alternative to my Amendment. Under their alternative, states could enforce state anti-fraud requirements in state courts in connection with leverage transactions but could not adopt any form of "regulatory requirements." The CFTC's version of the Committee intent would both duplicate and restrict existing state authority. The CFTC's Amendment would duplicate, in effect, the authority already granted to the states to enforce federal anti-fraud prohibitions in state courts against Commission registrants, including leverage firms. Furthermore, the CFTC alternative, by precluding states from enforcing any "other form of regulatory requirement" on any person engaged in leverage transactions, would have drastically reduced the states' existing power under the law to enforce state statutes of general applicability that might impose regulatory requirements on all persons doing business within a state.

The scheduling of the markup session on May 21, 1986, despite the good faith efforts of Representative Madigan and myself to rework the state jurisdiciton amendment in order to perfect its language consistent with the Committee's intent, signalled clearly to me that the Committee was about to give undue weight to the CFTC's inaccurate and largely irrelevant views on this subject. Since I did not want to be a party to the Committee's abdication of its legislative responsibility to the CFTC in this manner, I decided to withdraw my Amendment on state jurisdiction. This should not be interpreted by anyone to suggest that I believe that state jurisdiction over expanded leverage activity is in any way unnecessary. To the contrary, my conviction in this regard is stronger than ever begore. I simply did not want to participate in or in any way legitimize a process which purported to give the Commission the authority to veto the Committee's intent on May 7, 1986, when it adopted the concurrent state jurisdiction Amendment.

GLENN ENGLISH.

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